

SUMMARY

of the Audit on the Implementation and Social Utilisation of the Contracts of Cultural and Higher Education Priority Projects Implemented in PPP Schemes (1287)

Among the cultural and higher education projects carried out in PPP schemes, the State Audit Office of Hungary (SAO) already audited in 2006 and 2007 the Palace of Arts and the investment programme of the higher-education students' dormitories. In PPP schemes, private partners signed long-term contracts to build, renew and operate – using their own resources and bank loans – the facilities for a rental/service fee.

The previous audits primarily aimed at the preparation and the implementation of the development programmes, there was no information available on the fulfilment of contractual obligations. This fact and the magnitude of public funds utilized required a follow-up audit of the projects.

The objective of the follow-up audit was to evaluate:

- 1. whether the fulfilment of contractual obligations was carried out in an economical manner, taking into account the interests of the public sector;
- 2. whether facilities were operated in a controlled manner, according to the stipulations of the contract and ensuring the economical utilisation of public funds;
- 3. whether the social utilisation of public funds was ensured during the operation of the facilities.

The stand-by fee and the public utility costs of the Palace of Arts (MÜPA) generated HUF 40.4 billion budget expenditure between the handover of late 2005 and the end of 2010. In the course of the 30-year duration of the contract, ending in 2035, the projected stand-by fee – calculated with the average exchange rate of 2011 – will generate a further expenditure of HUF 198.2 billion. Further public funds are involved in the subsidization of the cultural organisations operating in the Palace of Arts. The average state expenditures related to the Palace of Arts amounted to HUF 13.3 billion per year in the audited period of 2007-2010.

Between 2004 and 2011, 24 projects at 15 institutions of higher education – among these are the construction of 8 student dormitories not belonging to the respective university and the reconstruction of 16 student dormitories belonging thereto – were carried out in the framework of the investment programme of the higher-education students' dormitories, in PPP scheme. As a result of the developments, involving dominantly 20-year commitments, 4460 individual places of accommodation were created and another 12 892 were modernised.

In the period of 2006-2010, ministerial contribution to the rental fees of the newly built and renewed student halls and hostels amounted to HUF 10.3 billion. This support, earmarked in the chapter of the central budget, will generate a further HUF 65.3 billion in expenditures until the maturity of the contracts.

Main findings

The Palace of Arts

1. Contractual obligations did not reflect the interests of the state.

According to the contract, the contracting party (the state) is due to pay the total net amount of the stand-by fee in EUR, despite the fact that 51.7% of the fee covers operational and renewal charges that incur in HUF at the private partner. On the other hand, inflation-indexed charges are determined using EUR inflation, different from domestic price changes.

The expected service parameters of technical operation were not defined in detail, thus accountability and verifiability are not ensured. The lump-sum, flat-rate operational charge does not allow the assessment of the economic viability of sub-tasks. The deterrent effect of the sanctions applied in case of inadequate services is limited, since a 1.0% decrease in the level of service generates only a 0.2% reduction of the total fee.

The funding of additional restoration and modernization, as stipulated in the contract, is also a significant financial burden for the public partner. From the delivery of the facility, up to the end of 2010, the contract includes additional charges of HUF 7.4 billion, covered by the stand-by fee payable by the contracting party. In the same period, the private partner accounted for an amortization of HUF 4.1 billion for the assets of the Palace of Arts.

The contract contains a provision according to which the state partner is only entitled to receive half of the residual value of the asset replacement fund –

financed by the contracting party (the state) - upon maturity of the agreement, which is clearly detrimental for the public sector.

2. The operation of the facility in a PPP scheme did not serve the economical utilisation of public funds.

The expenditures of the private partner related to the operation of the facility accounted for only slightly more than half of the amount of fees charged on the state. The renovation and asset replacement funds were used for financing maintenance works as well, which – according to the contract - should have been covered by the private partner from the operational fee separated from the funds.

The detailed content of operational services was not specified in the contract, therefore the contractual execution of the services could not be supervised and controlled.

The state partner did not establish a monitoring, evaluation and control system, capable of tracking the deficiencies of operation.

The ministry (Ministry of Education and Culture, later Ministry of National Resources) entrusted MÜPA Ltd. (established by the ministry) to perform the supervisory tasks arising from its role of principal. From 2010, the Ministry of National Development is responsible for supervising PPP projects, however, the re-regulation of the relationship, scope and functions of the Ministry of National Resources, the Ministry of National Development and MÜPA Ltd. has not been performed.

3. The cultural activity of the Palace of Arts was effective, based on the number of visitors and ticket revenues, the social utilisation of public funds was guaranteed.

The ministry responsible for culture did not define the cultural, economic and social objectives to be reached with the operation of the institution. However, the goals defined in the strategic and business plans of the cultural organisations operating in the Palace of Arts were achieved. In 2007, 733, in 2010, 1031 cultural events took place at the Palace of Arts, which attracted 562 502 visitors in 2007 and 755 293 visitors in 2010. The average utilisation of the facility was above 80.0% between 2007 and 2010 on average.

The investment programme of higher-education students' dormitories

1. The contractual provisions of risk sharing applied by the projects of the investment programme of students' dormitories did not represent the interests of the public sector.

Under the contracts, higher education institutions bear the majority of financial risks (exchange rate, interest rate and inflation related risks), which – due to unfavourable economic events – placed a significant additional financial burden on them. The contracts stipulated the possibility of acquiring the facilities at a residual value; however, in case of two-thirds of the projects, the institutions did not have accurate information on the expected amount of residual value or the accounting method related to it.

The contractual condition, according to which in the case of deficient or incomplete execution, penalties are calculated on the basis of the operational fee (and not from the higher, total fee), did not serve the interests of the contracting party.

2. The technical operation of the student hostels and the renovated student dormitories was in accordance with both contractual obligations and the expectations of the contracting party and the users, however the economy of the PPP scheme was not justified.

Operational and public utility expenses per accommodation were 16.9% higher in student hostels constructed and 2.2% higher in student dormitories renovated in PPP scheme in comparison with the specific indicators of traditionally operated student dormitories.

Half of the institutions did not have information on the utilisation of the replacement-renovation funds set aside for the quality preservation of the facilities. The implementation of the renovations and the economy of the utilisation of the funds was not monitored.

3. Based on the level of utilisation of the student hostels and renovated student dormitories between 2007 and 2010, the social utilisation of public funds was ensured in the audited period.

The housing conditions of students improved as a result of the developments. The level of utilisation of the facilities operating in PPP schemes reached 95.1% in the audited period, exceeding the 93.1% average utilisation of traditional student dormitories.

The utilisation of modernized student halls and dormitories linked to provincial higher education institutions with a smaller catchment area was low or decreasing in 2011. The lowest level of utilisation was 75% in case of hostels and 46% in case of renovated student dormitories.

Recommendations

Based on our findings, we recommended the Minister of National Development to take measures for the definition of the contents and parameters of operation services in an itemised, verifiable way, in order to ensure full accountability. Furthermore, we proposed investigating the question of personal responsibility related to the damages caused by disadvantageous contractual conditions in the audited cultural and higher education projects. Based on the findings of the investigation we propose beginning impeachment and damage mitigation measures.

We also recommended the Minister of National Development to take measures for the clear definition of the relationships among the Ministry of National Resources, the Ministry of National Development and MÜPA Ltd., in collaboration with the Minister of Human Resources.