



Solidity and use of the requests for additional funds to increase the fixed capital of the state-owned enterprises managed by the Ministry of Health to cover the costs incurred due to the COVID-19 outbreak

Interim report



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Inspections carried out and an interim report drafted within the framework of the financial audit “On the annual financial statement of the Republic of Latvia on the execution of the state budget and municipal budgets” (Audit schedule No 2.4.1-36/2020 of the Audit and Methodology Department of the State Audit Office of 13 July 2020) and following Sub-paragraph c), Paragraph 3, Section 3 of the State Audit Office Law.

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Why have we drafted this interim report?

Since International Standard on Auditing (ISA) 701, Communicating key audit matters in the independent auditor's report¹, has taken effect, the State Audit Office is required to assess the need to include key audit matters in the audit opinion on the financial statements.

For the purposes of those standards, key audit matters are matters that, in the auditor's professional judgment, are significant in the context of the audit of the financial statements of the reported period that one reports to the management of an audited entity and that have been the focus of the auditor's attention. There is no separate opinion on the key audit matters issued.

The information provided on key audit matters serves as additional information for potential users of the financial statements. It helps apprehend both matters that the auditor has identified as significant in the professional judgment and the audited entity and the areas where the management of the audited entity has made significant judgments while drafting the audited financial statements. This information may also serve as a basis for potential users to communicate further with the management of the audited entity about specific aspects of governance, audited financial statements, or audits performed.

The solidity and actual spending of the requests for additional funds allocated to address the consequences of COVID-19 are the key audit matter, which is crucial in all financial audits on the accuracy of drafting the annual consolidated financial statements for 2020 of ministries and central governmental agencies.

In 2020, the COVID-19 pandemic affected Latvia like the rest of the world. The Cabinet of Ministers adopted a decision to declare the emergency on 12 March 2020, which continued until 9 June 2020² and was declared once again on 9 November 2020³. The extraordinary circumstances caused by COVID-19 affected the daily lives of the government, the public, and everyone both during and after the emergency. The new conditions required the ability to react and adapt quickly and caused deviating from the usual order. Under the new conditions, the institutions should have been able to coordinate their activities more intensely and cooperate with each other by avoiding legal formalism and the departmentalism to ensure the functioning of the state and the protection of each individual in emergency conditions⁴.

Overcoming the COVID-19 pandemic and dealing with its consequences have required significant funds from the state budget. Since the declaration of the state of emergency, the Cabinet of Ministers has made decisions in connection with overcoming the crisis caused by COVID-19 and eliminating its consequences on the allocation and reallocation of state budget funds for the implementation of basic functions for 1,206,152,454 euros in total by 31 December 2020 and has examined proposals for reallocation of funds for the performance of projects and measures co-financed by European Union policy instruments and other foreign financial assistance for 499,029,112 euros.⁵ The State Audit Office pays special attention to assessing the spending of state budget funds allocated for overcoming the COVID-19 pandemic, preventing, and mitigating its consequences.

The Cabinet of Ministers has allocated additional funding of 87,318,317 euros to the Ministry of Health for overcoming, mitigating, and preventing the consequences of COVID-19 by 31 December 2020.

To provide information on the key audit matter raised in the financial audit “On the annual financial statement of the Republic of Latvia on the execution of the state budget and municipal budgets” – solidity and actual spending of the requests for additional funds allocated to curb the COVID-19 consequences, the State Audit Office audited and drafted this interim report on the funding of 14,897,134 euros granted to the Ministry of Health.

Summary

The Ministry of Health was allocated funding of 14,897,134 euros⁶ for the capacity- building of the largest hospitals in the country according to the development of the epidemiological situation and providing the medical equipment necessary for the provision of healthcare services to COVID-19 infected patients. Funding was allocated to the Ministry on 8 April and 5 May 2020, respectively to make financial investments, including:

- ❖ 788,297 euros into the fixed capital of Limited Liability Company “Riga Eastern Clinical University Hospital” (hereinafter referred to as the Eastern Hospital);
- ❖ 14,108,837 euro in the fixed capital of university hospitals, including 6,798,925 euros in the Eastern Hospital, 3,698,365 euros in state-owned limited liability company “Pauls Stradiņš Clinical University Hospital” (hereinafter referred to as the Stradiņš Hospital), and 3,611,547 euros in state-owned limited liability company “Children’s Clinical University Hospital” (hereinafter referred to as the Children’s Hospital).

The audit has provided assurance that the Ministry of Health has used the allocated funds of 14,897,134 euros according to the purpose of the allocation by investing in the fixed capital of the Eastern Hospital, the Stradiņš Hospital, and the Children’s Hospital in 2020.

The Ministry of Health took two different approaches to invest in the fixed capital of the hospitals, wherefrom, in the opinion of the auditors and the Ministry itself, more precise to achieve the objective of the allocation was the one used in the case of the Eastern Hospital. The funds allocated in April 2020 were invested in the fixed capital of the Eastern Hospital by compensating the hospital’s actual expenses for the purchase of medical equipment. The Ministry of Health increased the fixed capital of the hospital only after the purchase of medical equipment and identifying the exact amount by making a financial contribution of 788,297 euros. The audit revealed that the purchased medical equipment was in line with the plan and the Board and the Council of the Eastern Hospital had also approved their purchase.

In its turn, the Ministry of Health chose to invest the funding allocated for the purchase of the medical equipment needed for increasing hospitals’ capacity and providing healthcare services to COVID-19 infected patients in May 2020 in the fixed capital of university hospitals (the Eastern Hospital, the Stradiņš Hospital, and the Children’s Hospital) before the procurement of medical equipment, without knowing the exact costs. The Ministry of Health explained the choice by

stating that hospitals needed resources immediately during the emergency and had the professional competence to carry out such procurements.

The audit discovered that the responsible employees of the university hospitals, in cooperation with the Ministry of Health, compiled lists of medical equipment, indicating the names of the equipment and the amount of indicative funding required for their purchase. The Ministry submitted those lists to the Cabinet of Ministers. Based on the submitted lists, the Cabinet of Ministers decided to increase the fixed capital of university hospitals by 14,108,837 euros to cover the expenses incurred by the hospitals in connection with the COVID-19 outbreak, including the purchase of medical equipment.

The auditors consider that there is no reason to question the need for listed medical equipment to enable the hospitals providing healthcare to COVID-19 infected patients, as:

- ❖ The responsible employees of the university hospitals with appropriate professional competencies in medical technologies compiled the lists, which the meeting of the Responsible Institutions and the State Operational Medical Commission approved;
- ❖ Hospital governance institutions (Boards and Councils) have approved the conclusion of agreements, as well as received the approval of the meeting of shareholders' meeting under the Articles of Incorporation of the university hospitals, for example, the Eastern Hospital has received a permit from the Ministry of Health to execute extraordinary procurement of the equipment included in the list on 14 April 2020.

When assessing the use of the funds invested in the fixed capital of the university hospitals, the audit has obtained assurance that the hospitals have purchased medical equipment included in the approved list with insignificant deviations (0.7%) in 2020, however, savings of EUR 1,872,231 have been generated, which hospitals will be used for the purchase of other non-listed medical devices and equipment. At the same time, savings of 1,872,231 euros have occurred, which the hospitals will use to purchase other medical devices and equipment not originally listed.

When comparing the lists of medical equipment submitted to the Cabinet of Ministers with the data of hospitals on the purchased equipment (or with the concluded purchase agreements), according to the auditors' estimates, four of the planned 114 medical devices were not purchased for the total amount of 103,517 euros or 0.7% of the allocated funding. The hospitals explained that they had decided after re-evaluation that the equipment was not urgently needed or that the hospital's priorities changed.

However, the audit revealed deviations from the initially planned funding for the purchase of medical equipment, resulting in financial savings of 1,768,714 euros or 13% of the initially planned, as 70 medical devices were purchased at lower prices, resulting in financial savings of 2,303,354 euros, while 29 medical devices were purchased at higher prices than planned, resulting in a financial shortage of 534,640 euros, and the cost of purchasing the two medical devices was in line with the original plan. Moreover, the actual cost of purchasing nine medical devices is not yet known, as contract negotiations are ongoing with suppliers.

The Ministry of Health has explained to the auditors that the hospitals plan to spend the financial savings on purchasing medical equipment and technology needed to operate in the event of a

COVID-19 outbreak and not included in the original list due to limited financial resources. In particular, the Ministry of Health emphasises that any changes to the approved list for the purchase of equipment, namely, changes in the number, price, and total planned funding are the responsibility of the hospital Councils.

The auditors find that the decentralised approach to the purchase of medical equipment needed for the provision of healthcare services to COVID-19 infected patients has resulted in the choice of the medical equipment required for healthcare be decided by each hospital separately, with no one taking responsibility for them at the national level. It has also not promoted the economical use of the funding allocated from the state budget. Although the Ministry of Health has indicated that joint procurement for the purchase of the medical devices that the hospitals required would not be as effective as possible, the auditors point out that the decentralised approach has resulted in higher costs, such as:

- ❖ The Eastern Hospital has purchased 13 central patient monitoring stations by paying 9,980 euros without VAT for each station, while the Stradiņš Hospital has purchased three stations by paying 12,000 euros without VAT for each station because they were delivered to the Stradiņš Hospital in a shorter time and less quantity, so the costs of station installation and configuration per unit were higher;
- ❖ Although according to the list, the purchase of the same equipment for both the Eastern Hospital and the Stradiņš Hospital has been approved under several items, providing for the purchase at the same prices, the inspection revealed that the hospitals had set different technical requirements and specification, thus affecting equipment costs, and making them even more expensive in some cases. For example, the cost of one intensive care bed in the Eastern Hospital is 4,712 euros without VAT, but the Stradiņš Hospital has bought them for 657 euros more because the beds are equipped with a lateral tilt, they include infusion stands with two hooks and two bottle holders, a stand-up bar, extension mattress, nursing console, side railing console, and foot console.

According to the auditors, a centralised agreement on the range, specification, and technical requirements of the medical equipment needed to increase hospitals' capacity and provide healthcare services to COVID-19 infected patients would both allow more accurate quantification of the funding required to purchase the medical equipment and minimise concerns and discussions about the need of the purchased equipment for the provision of healthcare to COVID-19 patients in particular.

The audit, which carried out inspections in all three university hospitals on the organization of purchases of medical equipment necessary for the care of COVID-19 patients, found that the hospitals had elaborated procedures for emergency procurement by determining mandatory procurement activities, following the recommendations developed by the Corruption Prevention and Combating Bureau in cooperation with the Procurement Monitoring Bureau for procuring during an emergency. The audit provided assurance on the transparency of medical equipment procurement processes, including the traceability of decision-making.

Recommendations by the State Audit Office

The audit provides two recommendations, whose implementation will facilitate the effective and economical use of state budget funds following the intended purpose. The State Audit Office calls on the Ministry of Health:

- ❖ To choose a type of fixed capital increase which ensures the use of the funds for the specific purpose as precisely as possible when investing in the fixed capital of state-owned enterprises managed by the Ministry;
- ❖ To assess whether the approach to decentralised procurement procedures in the state-owned enterprises provides the most economical use of the funds.

References

- ¹ The International Organisation of Supreme Audit Institutions (INTOSAI) also uses International Standards on Auditing for the financial audits; hence, the latter are binding on the State Audit Office under Section 1.3 of the State Audit Office Law, which conducts audits in accordance with international standards on public sector auditing
- ² Cabinet Order No 103 “On Declaring a State of Emergency” of 12 March 2020.
- ³ Cabinet Order No 655 “On Declaring a State of Emergency” of 6 November 2020.
- ⁴ Communication of the President of Latvia No 8 “Basic Principles of Activities of State Constitutional Bodies in an Emergency Situation” of 23 March 2020.
- ⁵ Article 2, Informative Report “On redistribution of financing from the European Union Structural Funds and the Cohesion Fund and solutions for mitigating the consequences of COVID-19” of the minutes No 34, § 33 of the Cabinet sitting on 19 May 2020.
- ⁶ Order No 117 of the Ministry of Finance “On Increase of Appropriations” of 8 April 2020 and No 148 “On Increase of Appropriations” of 5 May 2020.