



How are small ports managed?

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Audit report

How are small ports managed?

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Compliance audit “Does one ensure legal, effective, and efficient management of the ports established by local and regional governments?”.

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The audited entities are Dienvidkurzeme, Limbaži, Saulkrasti, Talsi, Tukums Regional Governments and Jūrmala City Municipality, Engure, Jūrmala, Mērsrags, Pāvilosta, Roja, Salacgrīva and Skulte Port Authorities.

The cover design uses photos from the personal archive of the auditors.

Summary

Latvia is located on the Baltic Sea, and there are 10 ports established on its coast, including seven small ports. Although the cargo turnover of small ports is small against the background, they are elements of a crucial logistics chain and contribute to the development not only of the port area, but of an entire region, as local residents are employed in small ports and companies related to port services, which sometimes have been working in this industry for several generations.

Latvia's small ports specialise mainly in the export of logs, wood chips and wood pellets, granite chips and other building materials, peat and receiving fresh and frozen fish. In recent years, more and more small ports have been servicing yachts, offering repair, winterization, and other services to sailors from Nordic countries, Eastern and Western Europe, thus promoting Latvia as a tourist destination.

Latvia's transport and logistics system and infrastructure should be used effectively for the benefit of the national economy. Good governance and efficient operation of small ports is an essential prerequisite for the use of public assets at their disposal in the interests of population, businesses, local and regional governments, regions and the country.

Main conclusions

In the governance of small ports, irregularities have been found in almost every aspect of management and their performance such as strategic management and development planning, financial management and handling of financial resources and property, in the introduction and monitoring of an internal control system. Moreover, port authorities have not complied with the requirements of laws and regulations binding on them in several cases.

Without eliminating all irregularities and without streamlining the processes of port management, especially without registering all watercrafts serviced in a port, appropriate analytical records of revenues and costs, it will be impossible for local and regional governments as the owners of these ports to assess the effectiveness and efficiency of the economic activity of small port authorities. Indicators of the number of watercrafts and cargo turnover, without evaluating them in relation to revenue, cost, return indicators and the ability to generate sufficient financial resources for port development, do not provide impartial information to assess the effectiveness of port operations.

Without improving strategic and development planning linking it with financial planning, in particular, by elaborating the long-term financial forecast for five years specified in the law and without setting clear achievable goals and measurable performance indicators characterizing the degree of their achievement, it will not be possible to manage and develop ports strategically in the long term.



Summary



Description of the sector



Conclusion

Justification

Recommendation



Opinion of the state
institution concerned

Audit profile

Development, strategic and financial planning

One of the reasons that certainly does not facilitate optimal and effective use of small ports as a public asset and resource in the interests of the entire national economy, including given various sectors like transport and logistics, wood industry, agriculture, fisheries, etc., is the fact that **the role, significance and future perspectives of small ports are not sufficiently integrated in development planning documents at the national level**. They do not define the directions and priorities of small port performance, therefore there is no interest in the operation of small ports on a national scale currently and has not been for a long time.

The Regulation of the European Parliament and the Council also stipulatesⁱ that the full integration of ports in seamless transport and logistics chains is needed to contribute to growth and a more efficient use and functioning of the trans-European transport network and the internal market. This requires modern port services that contribute to the efficient use of ports and a climate favourable to investments to develop ports in line with current and future transport and logistics requirements.

However, taking into account the geographical location of small ports, the drastic **changes in the geopolitical situation**, the impact of the sanctions imposed on Russia and Belarus on various sectors (especially energy and wood industry), greater involvement in the strategic and development planning of small ports is necessary at the national, regional and municipal levels to **ensure the continuity and sustainability of small ports**.

In addition, **local and regional governments as founders of port authorities have not been “up to the task”** because they have not been properly involved in development planning of ports by setting specific goals and achievable indicators, monitoring and analysing the results of port management and return of public assets in accordance with the interests of the local or regional government, its population and businesses.

Despite the fact that the municipal development planning documents regarding the development of small ports set goals and actions for improving port operations and infrastructure, they lack **quantitative and qualitative performance indicators to evaluate whether the activities of local and regional governments and ports have achieved specific results** by providing governance of public assets (ports water area, territory and infrastructure) in small ports, and whether the local or regional government, its population and businesses get the maximum benefit from these assets.

While assessing **the responsibilities of the small port authorities** in development planning, one can conclude that **they do not carry out development planning in accordance with the legal framework and principlesⁱⁱ**, as the required documents have not been drafted or updated. Engure and Roja Port Authorities have not developed but Skulte Port Authority has not updated the port development program, the connection between development and budget planning is not ensured, the principle of financial opportunities is not respected because only Roja and Salacgrīva Port Authorities have drafted an estimate of the use of financial resources for five years.

Engure Port Authority has not elaborated one of the most important documents regulating the operation of the port, that is, port regulations. The port regulations contain information on fees for services applicable in the port, the borders of the port's land and water area, regulations on watercraft traffic in the water area, vessel berthing, environmental protection, etc.ⁱⁱⁱ

Small port authorities must ensure the development of waste management plans and waste management in accordance with the statutory requirements^{iv}. The European Commission states^v that *Discharges of waste from ships pose an increasing threat to the marine environment, with costly environmental and economic consequences. Recently, the problem of marine litter has come to the fore, as a growing number of scientific studies provide evidence of the devastating effects on marine ecosystems and of the impacts on human health.*

However, Engure, Pāvilosta, Roja and Skulte Port Authorities have not updated their waste management plans for a long time (even more than 10 years).

Although small ports are mostly provided with the possibility to transfer waste water generated by ships and other watercraft, this option is not often used, which increases the risk that **waste water is discharged “directly” into water bodies, thus causing damage to the surrounding environment.**

Performance and supervision

The supervision of the operation of small ports by the port boards does not comply with the statutory regulations^{vi}. For example, the managers do not provide port boards with the regular reports on the performance of the ports as stipulated in the regulations, the calculation of the return on assets indicators and the analysis of the results are not carried out, therefore decision-makers, including local and regional governments, do not have information to make operational, impartial and economically justified decisions about the port’s operation and development.

In the annual reports of small port authorities for the year 2020, **no information is disclosed about owned properties worth at least 6,456,407 euros**, which, in its turn, prevents the users of financial reports, including the local or regional government from evaluating the port’s economic activity, as it is impossible to obtain data on the efficiency of the used state and municipal assets. When calculating the long-term investment return on investment, for instance, taking into account only the information presented in the financial report of Jūrmala Port Authority, it is several times higher than if the calculation includes the value of all long-term investments in possession and ownership.

The indicators of the economic activity of small ports in 2020 show that **the economic activity of not all port authorities can be considered effective** (See Table 12).

The annual report of Salacgrīva Port Authority shows losses^{vii} for the first time in 2020, Roja Port Authority has been working with losses for the second year, and Pāvilosta Port Authority – for the third year. Profitability also varies among small port authorities from 0.3% for Jūrmala Port Authority to 19% for Engure Port Authority.

Several factors influence the indicators of economic activity of port authorities, however, comprehensive analysis is impossible because **the prime cost of the provided services is not calculated and controlled in any of the port authorities.**

When assessing the performance of small port authorities, it can be concluded that they are able to implement projects for the development of their territory and infrastructure only by attracting external funding. **The financial results and return indicators of the ports themselves show negative trends.** From their own revenues, the small ports are unable to finance their activities and ensure proper maintenance of the infrastructure without additional external financing, including the attraction of investments from businesses.

Appointment, activity and remuneration of board members

During the audited period, **the number of board members employed did not meet the legal framework** in five^{viii} of the seven small port Boards, as representatives of all the specified ministries were not represented on the board, and the proportion between the number of representatives of the local or regional government and entrepreneurs was not respected. However, according to the auditors, the boards of small ports employ **a disproportionately large number of board members**, as it does not depend on the directions of the ports' operations and the amount of work to be performed. For example, three out of seven small ports do not provide cargo turnover, respectively provide a narrow range of services, but the number of board members of the port is the same as in ports providing a wide range of services.

In addition to that, if the same principles were applied in determining the number of board members of small ports as for state-owned or municipal enterprises of public entities^{ix}, then they would be comparable to a small state-owned or municipal enterprise with a maximum number of board members of two taking into account the performance results of small port authorities.

Contrary to the principles of good governance, **the performance results of board members of small ports are not evaluated**, thus not using evaluation as a tool for assessing the effectiveness of the results of the joint work of board members and the Board and for increasing professionalism.

At least five port officials have found themselves **in a conflict of interest** while ensuring the operation of the port and performing their duties **as public officials**, as they have participated in decision-making in their interests. During the audit, the Corruption Prevention and Combating Bureau imposed administrative penalties on two officials.

Besides, contrary to the law^x stipulating that state officials must obtain permission to combine positions, **several port officials have not received permission to combine positions, thus the risks of entering into a conflict of interest have not been assessed**.

The remuneration of employees of small port authorities is determined and paid in accordance with the statutory requirements. There are individual cases detected where the principles of good practice have not been observed when Mērsrags Port Authority paid out bonuses to employees for half-year results without evaluating the individual contribution of employees during the audited period, by spending **181,176 euros** in total.

Managing financial resources and property

The establishment of a clear framework with transparent, fair and non-discriminatory rules regarding the financing of port infrastructure and charging for port services is essential to ensure that the commercial strategy and investment plan of the port and, where appropriate, the general port policy of the country are fully compliant with competition rules^{xi}.

Although port authorities have developed and approved price lists for providing services, Engure, Pāvilosta, Mērsrags, Roja and Salacgrīva Port Authorities **have not developed a methodology for calculating and determining threshold levels of port fees and service tariffs and service fees**.

In such a situation, there is a risk of not earning full revenues, as **the prime cost of provided services is not determined taking into account the actual direct and indirect costs and revenues**, and **the opportunity to generate such cash flow that would be diverted to the maintenance and development of the port infrastructure is prevented**.

Irregularities in the operation of internal control system have also been identified, preventing possibility to gain confidence **whether the port receives all the revenues due to it** from all the services provided in full and in accordance with the approved tariffs. There are cases established when the service fee is not collected by mistake in accordance with the approved price lists.

The actions of the small port authorities with the long-term investments in their ownership and possession by leasing the state land transferred to the possession of the port authorities, does not comply with the statutory requirements^{xii} and good practice. **Income from land lease is not obtained to the maximum extent possible**. According to the estimate made by the auditors, small port authorities **could have received at least 119,669 euros more revenue from land lease**^{xiii} from 2019 to 2021. There are several reasons for this:

- None of the small port authorities has published aggregated information about the leased and available objects for lease in the port in accordance with the statutory requirements^{xiv} thus not promoting competition and not providing equal opportunities to potential lessees;
- Engure, Jūrmala, Pāvilosta, Roja un Skulte Port Authorities have not developed a methodology for determining land rent in the port;
- Pāvilosta Port Authority has transferred the real estate in its possession or ownership for free use contrary to the law^{xv} while Jūrmala Port Authority did so contrary to the procedure established by the municipality^{xvi};
- In land lease agreements, the goals of real estate use are defined in general terms without specifying a specific type of business or the use of the parcel. Hence, disproportionately low land rent charges are applied that do not meet the interests of the economic development of ports;
- In land lease agreements, four port authorities^{xvii} have provided for a constant amount of rent charge as euro per year for the entire land property or euro per square meter instead of applying rent charges according to the land survey value, thus the rent charges in long-term lease agreements are not appropriate to the economic situation and unbiased level in the sector.

In addition to that, Pāvilosta and Skulte Port Authorities **have transferred fixed assets purchased within the framework of EU Structural Fund-financed projects to businesses for use free of charge** disrespecting statutory requirements^{xviii}, as well as infrastructure objects obtained for use with less co-financing of the businesses' project, respectively with greater financial state/municipal support, thus possibly allowing for businesses to receive support for commercial activity that is not provided for in laws and regulations.

Also, **the actions of local and regional governments and small port authorities with the attraction of financial resources does not comply with the sources of funding allowed for the operation of port authorities**^{xix} and the procedure set out in the laws^{xx} because:

- Three^{xxi} port authorities have received financial resources in the form of loans from port businesses;

- By pre-financing the activities of the project implemented by Engure Port Authority in the total amount of at least **324,369 euros**, Engure Regional Government has issued a loan to Engure Port Authority.

Key recommendations

Based on the audit findings and conclusions, a proposal was made to the Ministry of Transport to integrate small port development issues into national planning documents. Small port authorities and local and regional governments are provided 10 recommendations to eliminate irregularities and implement port management and operation in accordance with laws and regulations and principles of good governance:

- ❖ Ensure development planning and strategic management in accordance with the statutory requirements by elaborating high-quality planning documents and providing monitoring and evaluation of port operations;
- ❖ Assess the port management model (municipal institution or state-owned or municipal enterprise), taking into account the port's directions of operation, types of cargo and turnover indicators, as well as a required number of board members, develop criteria for the selection of board members and evaluate the results of a Board's performance;
- ❖ Monitor risks of conflicts of interest and risks in case of combining positions;
- ❖ Publish aggregated information about the objects leased and intended for lease in the port in accordance with the statutory requirements^{xxii} and develop procedures and criteria for concluding lease agreements and determining rent charges, as well as improve internal control system for monitoring and controlling the execution of lease agreements;
- ❖ Assess and include clear and true information about the assets in possession in the annex to an annual financial statement;
- ❖ Draft methodologies for accounting of revenue and expenditure and for determining economically justified service fees, as well as establish an internal control system to ensure the completeness of the collection of corresponding payments owed to them.

References

- i Article 1 of Regulation (EU) 2017/352 of the European Parliament and of the Council of 15 February 2017 establishing a framework for the provision of port services and common rules on the financial transparency of ports.
- ii Section 5 of the Law on Development Planning System.
- iii Section 6 of the Ports Law (the name of the law until 26 April 2022 was the Law on Ports).
- iv Sections 36, 37 and 41 of Cabinet Regulation No 455 “Procedures for Acceptance of Ship-generated Waste and Waste Water and Development of Ship-generated waste management plans” of 8 October 2002 (valid until 31 March 2022); Sections 65, 70 and 72 of Cabinet Regulation No 193 “Procedures for Acceptance of Ship-generated Waste and Procedure for Development of Ship-generated Waste Management Plans” of 22 March 2022.
- v Proposal for a Directive of the European Parliament and of the Council on port reception facilities for the delivery of waste from ships, repealing Directive 2000/59/EC and amending Directive 2009/16/EC and Directive 2010/65/EU COM/2018/033 final - 2018/012 (COD).
- vi Section 42 of Cabinet Regulation No 7 “Model Regulation of the Port Authority”.
- vii The losses occurred due to the cost of dredging of the port of Salacgrīva Port of 505,400 euros in 2020.
- viii Engure, Jūrmala, Roja, Mērsrags, and Salacgrīva Port Authorities.
- ix Section 6 and Annex to Cabinet Regulation No 63 “Rules on a number of board members and council members of state-owned and municipal enterprises of public entity and public-private enterprises, as well as a maximum amount of monthly remuneration of board and council members” of 4 February 2020.
- x Section 7.5 of the Law on Prevention of Conflict of Interest in the Activities of Public Officials.
- xi Article 6 of Regulation (EU) 2017/352 of the European Parliament and of the Council of 15 February 2017 establishing a framework for the provision of port services and common rules on the financial transparency of ports.
- xii Section 1, Par. 2 Section 3 and Part two, Section 6.¹ of the Law on Prevention of Squandering of Financial Resources and Property of Public Entity.
- xiii Jūrmala Port Authority 247.86 euros, Mērsrags Port Authority 1,860.11 euros, Pāvilosta Port Authority 24,692.03 euros, Roja Port Authority 63,832.33 euros, Salacgrīva Port Authority 18,834.10 euros, and Skulte Port Authority 10,203.38 euros.
- xiv Section 1 and Section 6.¹ of the Law on Prevention of Squandering of Financial Resources and Property of Public Entity.
- xv Section 5 of the Law on Prevention of Squandering of Financial Resources and Property of Public Entity.
- xvi Paragraphs 1 and 9 of Binding Regulation of Jūrmala City Municipality No 15 “Procedure for Determining the Rent Charge of Undeveloped Parcels or Their Parts Owned and Dependant by Jūrmala City Municipality” of 8 June 2016 (approved by the decision of the Jūrmala City Council on 8 June 2016 (minutes No 7, p. 50)).
- xvii Mērsrags, Pāvilosta, Skulte, and Salacgrīva Port Authorities.
- xviii Section 5 of the Law on Prevention of Squandering of Financial Resources and Property of Public Entity.
- xix Part one, Section 12 of the Ports Law (the name of the law until 26 April 2022 was the Law on Ports)
- xx Par. 7, Part one, Section 12 of the Ports Law (the name of the law until 26 April 2022 was the Law on Ports); Part two, Section 4 of the Law on Prevention of Squandering of Financial Resources and Property of Public Entity; Chapter I of the Law on Budget and Financial Management “Terms Used in the Law”, grants – state budget funds that are allocated to other budgets, businesses, associations and foundations, and other institutions in accordance with the procedures specified in the laws and regulations to ensure the performance of state or municipal functions.
- xxi Engure, Roja, and Pāvilosta Port Authorities.
- xxii Part two, Section 6.¹ of the Law on Prevention of Squandering of Financial Resources and Property of Public Entity.