



Problems and opportunities for the development of public procurement

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Audit report

Problems and opportunities for the development of public procurement

8 November 2024



Performance audit “The efficiency of the public procurement system in the Interior and the state public procurement policy affecting it”, where two audit reports, “The efficiency of the public procurement system in the Interior” and “Problems and opportunities for the development of public procurement”, were drafted.

The audit was conducted by Senior State Auditor, Lawyer Agnese Oļševska, Senior State Auditor, Lawyer Iveta Laicāne (until 11 December 2023) and Senior State Auditor Linda Freidenfelde-Purgaile (from 18 April 2024), State Auditor, Lawyer Elīna Krauze (from 1 November 2023), Head of the Responsible Sector Kaiva Skalbiņa, Department Director Kristīne Jaunzeme (until 19 May 2024), Department Director Gatis Litvins (from 20 May 2024) based on audit schedule No 2.4.1-1/2023 of the Second Audit Department of the State Audit Office of Latvia of 2 January 2023.

Audited entities: Ministry of the Interior, Ministry of Finance.

The cover design includes an image generated on 8 October 2024 by means of AI tool *OpenAI ChatGPT/DALL-E*.

Dear Reader,

The State Audit Office of Latvia has completed audit “The efficiency of the public procurement system in the Interior and the state public procurement policy affecting it”, where two audit reports, “The efficiency of the public procurement system in the Interior” and “Problems and opportunities for the development of public procurement”, were drafted.

In this audit report “Problems and opportunities for the development of public procurement”, we emphasise the need for a well-thought-out policy, effective regulation and professional procurement management. It facilitates the efficient use of state resources, ensures fair competition and the rule of law, including reducing the risks of corruption and the formation of cartels.

The procurement process creates administrative burdens and costs, therefore, proportionality between the benefits and costs of requirements must be safeguarded. Unjustified requirements can increase the cost of procurement. Each requirement must be justified, meaningful and appropriate to the purpose of a procurement. Simpler and clearer regulation facilitates its understanding and application, as well as reduces the likelihood of errors and improves the effectiveness of the procurement process.

Therefore, Latvia should implement the principle of best legislation as a priority and in the near future and conduct an ex-post evaluation of the national regulation. An ex-post evaluation would allow adjusting policy and practice based on data and achieved results, as well as strengthen Latvia’s position in the discussion initiated by the European Commission on changes to EU regulation.

The audit also concluded that the professionalism of decision-makers should be strengthened so that they could make effective decisions independently, rather than just follow instructions. Competent specialists promote



procurement effectiveness, reduce costs and ensure better results in the public interest. Appropriate knowledge and skills in economic, competition and legal issues allow specialists to influence the course of procurement processes actively and prevent potential risks that may arise at any stage of procurement like from market study and preparation of specifications to contract execution. Their ability to recognise and prevent potential risks in a timely manner both reduces the likelihood of delays and errors and increases transparency and trust in the procurement process significantly.

Centralisation of procurement is an essential solution to the challenges related to the complexity of the regulation and human resource capacity. It helps manage processes more effectively, reduce the administrative burden and improve the use of resources. Latvia has already achieved good results in this area compared to other EU Member States, however, there is potential for further improvements, especially in municipal procurement.

The Ministry of Finance, as the developer and implementer of procurement policy, has an important role not only in developing and maintaining the regulation, but also in monitoring its effectiveness to ensure optimal and responsible use of public funds. The understanding and support of the legislator is also necessary to create a transparent and efficient procurement system jointly.

I would like to express my sincere gratitude to my colleagues who participated in the audit and gave their best in drafting the report. I would also like to thank the industry representatives for their hard work and cooperation.

Respectfully
Mr Gatis Litvins
Department Director

Summary

Public procurement is an essential tool by which a state provides the resources necessary for the implementation of its functions, influences public and economic processes and achieves strategic goals.

Public procurement is financed from public funds and constitutes a significant part of public expenditure. In 2023, the total financial value of awarded procurement contracts by applying the provisions of Public Procurement Law, was 5.4 billion euros (excl. VAT), which was 14% of GDP. Therefore, it is essential that the implementation of public procurement is well-considered and effective so that public resources are spent optimally by purchasing the best for the available financial resources. At the same time, successfully and legally implemented public procurement must promote competition among suppliers and reduce corruption risks.

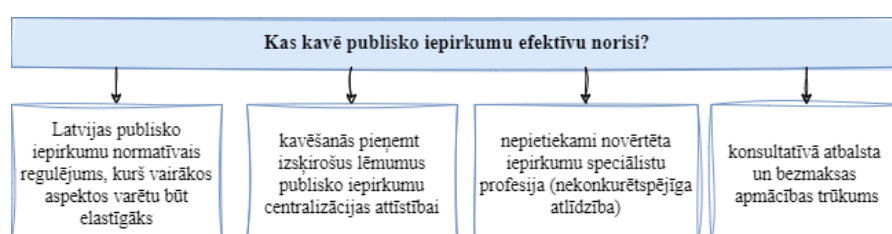
Successful procurement requires many prerequisites related to the legal framework, policy development objectives, as well as the professionalization of procurement practitioners. The audit includes, in the opinion of the State Audit Office of Latvia, the most pressing issues in the field of public procurement, where immediate action or in-depth assessment is possible and necessary, including areas that have been neglected partially so far and where the approach used so far should be reviewed.

The audit assessed generally how the state public procurement policy under the responsibility of the Ministry of Finance affected the implementation of public procurement.

Main conclusions

The public procurement system and legal framework of Latvia need improvements to ensure a simpler and faster procurement process, in which the work invested by procurement specialists is proportionate to the result obtained.

Several factors hinder the effective conduct of public procurement such as the regulatory framework of public procurement in Latvia, which could be more flexible in several aspects; delays in making crucial decisions for the development of public procurement centralization; the undervalued position of procurement specialists, as evidenced by the uncompetitive remuneration of procurement specialists; as well as insufficient advisory support and free training.



National public procurement rules are stricter than the requirements of the Public Procurement Directive

The public procurement process should be sufficiently fast, simple and understandable. However, in Latvia, public procurement regulations are frequently amended and are becoming

increasingly complicated. In 2020, only **16.5%** of customers of the Procurement Monitoring Bureau assessed the application of the legislation regulating the procurement area as understandable.

The EU Member States may choose how to regulate those procurements that do not reach the contract price thresholds for the application of the Public Procurement Directive 2014/24/EU (hereinafter – the EU threshold amounts). The Latvian legal framework of public procurement regarding these procurements is stricter in several essential issues than that provided for by the aforementioned Directive.

The Public Procurement Law stipulates the application of procurement procedures (open tender, restricted competition, etc.) from lower contract price threshold amounts than those provided for by the Directive. Although the rules for procurement below the EU threshold amounts can be relaxed by an EU Member State, the requirements for the Public Procurement Law are not significantly simpler than for procurements subject to the aforementioned Directive.

The fact that the threshold amounts for public procurement contract prices in Latvia are reviewed too rarely (in 2006, 2013, and 2017) also has a significant impact on the public procurement system. The threshold amounts have not been reviewed in line with the current economic situation, thus increasing the administrative burden for small-scale procurements, which are therefore subject to more complicated procurement regulations.

The Directive does not stipulate the conduct of procurement below its contract price threshold amounts, including the obligation for EU Member States to regulate “small” procurements. Despite this, the requirements for the conduct of “small” procurements in Latvia are relatively strict. There are some exemptions, for example, less reasons for excluding suppliers to be verified; price may be the only criterion for evaluating tenders; a report on the conduct of the procurement does not need to be drafted; submitting a complaint to the Procurement Monitoring Bureau is impossible. However, the requirements for “small” procurements are generally not simpler significantly than for procurement procedures.

In certain cases, a contract term longer than five years may be required to implement the subject of the procurement and the needs of the contracting authority in full (for instance, in innovation procurements). In such cases, the process of determining a longer contract term in the provisions of the Public Procurement Law than the one allowed by the Law is complicated. Although it is possible to determine the term of the procurement contract longer than that allowed by the Law in case of essential necessity, this requires the permission of the Cabinet of Ministers. Typically, state institutions do not use the opportunity to obtain a permit because it is a large and time-consuming bureaucratic burden.

The application of the rules for exclusion of suppliers set out in the Public Procurement Law is one of the most important and complicated issues. A contracting authority must ensure that a supplier should not be excluded from further participation for reasons such as various criminal offences, unpaid tax obligations, insolvency, violations of labour and competition law, conflict of interest situations, etc. However, in several respects, Directive 2014/24/EU allows EU Member States to use a more flexible approach in the application of exclusion rules, which is not always used in Latvia.

In addition, the Directive provides that EU Member States may provide for a derogation from the mandatory exclusion in relation to the exclusion rule for non-fulfilment of tax obligations

even where exclusion would be a manifestly disproportionate solution, including in cases where only small amounts of tax or social security contributions have not been paid. However, the legal framework provides that a supplier is excluded from a tax debt of 150 euros minimum in Latvia.

It is significant that currently **90%** of all excluded tenderers are excluded for non-fulfilment of tax obligations. Taking into account the audit findings, the State Audit Office of Latvia considers that legal framework for public procurement should be made easier to apply, thus promoting competition, reducing the bureaucratic burden and accelerating the procurement process. Therefore, an impact assessment of the Public Procurement Law, namely, an ex-post assessment, should be carried out.

Decisive decisions on the development of public procurement centralisation have still not been made

Centralisation of procurement is an effective way to optimise the public procurement process. Compared to other European countries, centralised procurement rate of Latvia in 2022 is the second best after Finland, according to the EC Single Market Scoreboard data, and has increased from 13% to 17% between 2019 and 2022. Yet, the European Commission only collects data on procurement procedures above the EU contract price threshold amounts. In fact, the total number of centralised procurements in the country averaged 9.4% from 2021 to 2023, with no significant growth trend in recent years.

According to the State Audit Office of Latvia, the development of comprehensive centralisation of procurement is likely to be limited by constant changes in decisions on further action. The State Administration Reform Plan 2020 stipulated that the centralization of procurement was one of the functions that should be provided in a single service centre but the new State Administration Modernisation Plan 2023–2027 no longer provided for this. In 2022, the government supported the proposal by the Ministry of Finance for the centralisation of procurement by determining the specialisation of state institutions in the procurement of a specific procurement item for the needs of the entire state administration. In its turn, the government documents indicated as early as June 2023 that the possibility of conducting centralised procurement within the framework of a single service centre was also being evaluated.

Since 2018, several new initiatives for centrally procured goods and services have been established by assigning their purchase to different state institutions for the needs of the entire state administration. Nevertheless, the new procurement centralisation initiatives have been only partially successful. Only two have been successfully implemented, that is, the fuel procurement organized by the State Defence Logistics and Procurement Centre and the electricity procurement organized by state-owned JSC “*Valsts nekustamie īpašumi*” (State Real Estate). The procurement for the purchase of laboratory materials, reagents and chemicals and the purchase of motor vehicles ended unsuccessfully, and the procurement for the purchase of transport services has not been organised. In their turn, feasibility studies of two more items (telecommunications devices and services, as well as natural gas) have not been conducted in more than two years. A general assessment of the effectiveness of these initiatives and the need for further implementation has not yet been conducted, and a deadline has not been set by which the Procurement Monitoring Bureau, in cooperation with ministries and the State Digital Development Agency (former State Regional Development Agency), should complete the

assessment. Lack of human resource capacity in state institutions, change of responsible persons in the execution of tasks, lack of deadlines are the reasons that limit further decision-making for the development of procurement centralisation by defining a clear development direction, goals and measures for their implementation.

Currently, centralised procurements are organized by various state institutions in different sectors by purchasing the same or similar items, including those that can be described as standardized. For example, mobile communications, translation, health insurance, transport rental, organization of business trips, and cleaning services. Such an approach does not contribute to reducing administrative costs in state institutions but it could be achieved by optimising the public procurement process. For instance, the electricity procurement conducted by state-owned JSC “*Valsts nekustamie īpašumi*” in the Dynamic Procurement System shows clearly that conducting centralised procurement can reduce administrative resources significantly since more than 70 state institutions and state-owned enterprises have joined one procurement. Namely, it reduced administrative expenses and time that would otherwise have been spent on conducting separate procurements in each state institution or state-owned enterprise.

Out of the 62 centralised procurement institutions, more than half of the total number of ministries and their subordinate institutions and a third of the number of local and regional governments on average carry out centralised procurements irregularly, for example, once or up to three times a year or even once every two years. Carrying out centralised procurements requires highly qualified procurement specialists with extensive knowledge and experience. If a centralised procurement institution carries out procurements seldom, it does not contribute to the professionalism of procurement specialists as specialists lack the opportunity to apply, maintain and develop their competence regularly.

The State Audit Office of Latvia finds that reducing a number of procurement institutions is necessary to optimise administrative costs and increase the impact of procurement centralisation while centralising procurement at the interdepartmental level. It means concentrating highly qualified specialists in a few competence centres by ensuring their specialisation in the stages and areas of procurement process. Carrying out centralised procurement in the smallest possible number of competence centres could also affect the increase in a number of strategic procurements positively (“green public procurement, socially responsible procurement and innovation procurement”), unified supervision of the procurement process, access, data and information accumulation, and predictability of costs and needs. The experience of other countries, such as Ireland, also shows that by optimising a number of participating organisations and designating one institution as a central public procurement authority with four main partner organisations in healthcare, defence, education, and municipal sectors, it is possible to achieve significant improvements in the public procurement system, promote cost savings, and improve procurement management.

At the same time, local and regional governments are involved insufficiently in the centralisation of procurement currently. Local and regional governments account for 81% of the number of customers of the Public Procurement Law but almost a third of local and regional governments did not organise centralised procurement in 2022 and 2023. Eight local and regional governments have not organised centralised procurement even once. A broader and more targeted involvement of local and regional governments in joint and centralised

procurement would allow for significant savings in public resources. Examples from other countries show that facilitating broader involvement of local and regional governments is possible by legally instructing each local and regional government to create centralised procurement institutions or jointly together with other local and regional governments.

According to the State Audit Office of Latvia, preparatory work has been carried out and all necessary information is available to make decisive decisions on the further development of procurement centralisation.

The role of procurement specialists in public administration is undervalued

When classifying positions of employees of state and municipal institutions, procurement specialist positions in the group “Supply (procurement)” are contrasted with positions that require high competence requirements and in-depth knowledge. The maximum possible monthly salary for a senior expert in procurement (the 10th monthly salary group) was up to 2,499 euros in 2023 but for a state-level centralised procurement executive (the 12th monthly salary group), it was up to 3,726 euros.

However, when determining the value of procurement specialist positions, not all significant circumstances to which procurement executives are exposed when performing their daily work duties are taken into account. In the assessment of the State Audit Office, it is important to take into account not only criteria such as experience, qualification, complexity, volume and performance of the work, but also the risk of corruption associated with the performance of the position. One should also note that two years after a public official has made a decision or participated in making a decision on public procurement, he or she is prohibited from acquiring the property of such an enterprise, becoming a participant, shareholder, member of such an enterprise or holding positions in an enterprise in relation to which this public official has made a decision on public procurement. It is especially important for centralised procurers who make decisions on a large number of enterprises, and their further professional work opportunities may therefore be limited significantly for a longer period of time.

There are institutions in the state administration that carry out a significant number of large-scale state-level centralised procurements but no position in the institution is classified in the group “Supply (procurement)”. Such a situation is possible if procurement is only an additional duty for an employee along with other more significant job duties or if procurement is the employee’s main duty but the position is not classified in the appropriate group. In both cases, such an employee will basically be required to have other competencies and professional qualification requirements in procurement than those required for a professional procurement specialist. It may have a significant impact on the public procurement area in the institution and the ability to ensure a successful result.

True information about a number and structure of staff involved in the performance of procurement function in state administration as a whole is of great importance for the development of a targeted procurement area and the professionalization of procurement specialists. Taking into account the nationally identified need to improve the qualifications of procurement specialists, they must be able to plan measures to improve the competence of procurement specialists in accordance with the target group and its needs. The availability of accurate data would also make assessing the compliance of available human resources with the volume of procurement to be carried out and the goals of centralisation of the state procurement

sector possible.

Although positions classified in the group “Supply (procurement)” can be set a competitive monthly salary in public administration, the actual opportunities are linked to the budget of a specific institution. Data analysis on the five sectors with the largest number of procurement specialists shows that the monthly salaries of procurement specialists in the 9th to 12th monthly salary groups differ by an average of 27% in different sectors. Overall, the lowest monthly salaries are set in the internal affairs sector.

In the five sectors analysed during the audit, the monthly salaries set for procurement professionals did not reach the midpoint of the respective monthly salary group at the end of 2023. It means that they lag behind the monthly salaries of equivalent positions in the private sector significantly. A large part, or up to 35%, of the total remuneration still consists of allowances, bonuses and cash prizes. However, the total average monthly remuneration of procurement professionals reached only the midpoint of the monthly salary group rarely in 2023. Hence, the monthly salaries of procurement specialists cannot be assessed as competitive in general considering their significant role and impact on the ability of public administration to perform its assigned functions properly.

The range of advisory support and free training for procurement specialists can be expanded

In 2023, the situation with the training of procurement officers has improved. In addition to the existing training opportunities, the State Administration School began to implement free training at the basic and advanced levels in cooperation with the Procurement Monitoring Bureau. However, there is currently a risk that after the project financed by the Recovery and Resilience Facility ends, this type and level of training for procurement specialists will not be continued.

The State Administration School and enterprises offer various paid training courses, however, the opportunities to attend them are affected by the funding available to state institutions for training expenses. A broader involvement of the staff of competent institutions in providing free training would allow saving public funds and would make training more accessible generally.

The range of free training for potential contractors is also limited. The quality of documents submitted by tenderers affects a successful conduct of procurement significantly. However, insufficient attention has been paid to educating potential contractors on issues relevant to them so far.

Surveys show that procurement entities particularly lack consultations by phone, and procurement entities are not always satisfied with their availability. At the same time, the Procurement Monitoring Bureau lacks the capacity to expand methodological support, and the Bureau plans to further reduce this type of support in the coming years.

The lack of qualified specialists has been felt for years. Obtaining higher education in public procurement in Latvia is impossible. Only some university master's and bachelor's study curricula provide for the acquisition of public procurement management.

Recommendations

Based on the audit conclusions, the Ministry of Finance has been provided with five recommendations for improving the public procurement sector. By implementing the recommendations of the State Audit Office of Latvia:

- The regulation in public procurement will be simpler, more understandable and more flexible;
- The level of centralisation of procurement will increase;
- The remuneration of procurement specialists will be determined taking into account the risk of corruption and restrictions on rights;
- Complete information will be provided on a number and structure of procurement specialists in public administration;
- At least 90% of procurement specialists of centralised procurement institutions working in the public sector will attend a certain amount of training in public procurement, as well as chairpersons of centralised procurement commissions will receive advanced training;
- Customer satisfaction with the methodological support of the Procurement Monitoring Bureau will increase and the time it takes for the Procurement Monitoring Bureau to provide a response within the framework of methodological support will decrease.

Recommendations provided by the State Audit Office of Latvia:

- The Ministry of Finance shall provide an ex-post assessment of the Public Procurement Law and propose improvements to the national legal framework, thereby facilitating competition, reducing the red tape and making the framework easier to apply;
- The Ministry of Finance shall propose the adoption of a decision on the further development direction of procurement centralisation based on the audit findings, the results of new initiative of centrally procured goods and services, the results of the survey and the recommendations provided by the OECD;
- The Ministry of Finance, as the developer and implementer of procurement policy, shall find a solution in cooperation with the State Chancellery so that the determination of the monthly salary of procurement specialists also takes into account criteria related to the risk of corruption and the impact of restrictions imposed on the position;
- The Ministry of Finance shall take measures to promote the expansion of free training opportunities for public sector procurement specialists and contractors, as well as continue advanced training of procurement specialists and establish it as mandatory at least for a chairperson of procurement commission in centralised procurement;
- The Ministry of Finance shall take measures in cooperation with the Procurement Monitoring Bureau to strengthen the capacity of the Procurement Monitoring Bureau in methodological support.