



Does SIA Rigas Mezi manage the municipal forest in compliance with legal requirements?

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Motivation

The Riga City Municipality (hereinafter – the Municipality) is one of the biggest forest owners in Latvia.

The forest and underlying ground is one of the main natural resources in Latvia. Production of wood products makes a significant part of the national economy, and the forest sector is one of the most important sectors of the national economy.

The forest with its products and services is also one of the most important sources of the public welfare. The forest provides timber for construction and furniture, and woody biomass for energy, place for living and food. It protects water resources and soil from erosion, provides a place for living for a significant part of the biological diversity. Besides, the forest is also a source of income for people, as well as it provides possibilities for recreation.

Due to the variety of possible use of the forest, as the needs of the society change, the forest policy and forest management should also change at the global, national and regional level.

In previous audits the State Audit Office pointed to deficiencies in the forest accounting and shortcomings in the accounting of activities carried out in the forest management related to both the management of the Municipal forest and the management of the Latvian state forest, as well as to shortcomings in the management of capital companies.

As a result of the audit the society will be informed about the compliance of the activities carried out by SIA Rigas Mezi (hereinafter — the Capital Company) with the legal requirements while managing the Municipal forest, as well as effective management of the Municipal Capital Company and suspension of unjustified commercial activities carried out by the Municipality will be promoted.



As a result of the audit the society was informed about the compliance of the capital company's operation with legal requirements.

Main Conclusions

The Local Government has allowed a situation when the operation of the Capital Company is principally oriented towards the implementation of Capital Company's economic interests — a wish to get maximum revenue from its economic activity — rather than systematic management of Municipality's forest area, because during the audited period the Municipality did not ensure proper management of the Capital Company since the implementation of the tasks delegated to the Capital Company were not effectively supervised.

Although the main precondition for sustainable forest management is development and implementation of a forest management plan, the Capital Company did not ensure that the making of felling sites complied with the forest management plan 2012-2016, meanwhile in 2017 the fund of felling sites was developed without approved forest management plans.

In order to obtain additional profits in 2013 the Capital Company expanded its operation beyond the task delegated by the Municipality — to manage the forest area — and participated in a commercial activity in the timber industry creating a structural unit — a sawmill Norupe. In the view of the State Audit Office such an action is not justified with the requirements of the law stipulating that the municipality is allowed to participate in a commercial activity, for example, to fill a market gap or to create goods of strategic importance for the development of municipality's administrative territory or national security.

In our view, participation of the Capital Company in a commercial activity in the forest industry distorts competition, which is showed by the following conditions:

- since 2003 the Capital Company does not sell the sawlogs (roundwood) obtained as a result of Municipality's forest management to private commercial entities operating in the timber industry, but consequently performs the processing itself in constantly increasing amounts, indicating 100% processing of all timber as its main challenge in the future. As a result in 2015 and 2016 it processed in total 91 th m³ of sawlogs (roundwood) thus reducing the amount of available raw materials in the free market and restricting the increase in the timber processing capacity of private commercial entities and their possibilities to gain additional revenue;
- by processing the sawlogs (roundwood) obtained as a result of Municipality's forest management the Capital Company obtains raw materials for lumber production three times cheaper than any other commercial entity of the wood processing industry in the free market. Besides, without the current advantage the Capital Company would experience higher roundwood processing costs than the income from the sale of the produced lumber.

Although the participation of the Capital Company in a commercial activity in the forest industry was aimed at gaining addition profits, its has decreased the profit rather than increased it. Despite the three times



The operation of the Capital Company should not be regarded as systematic management of Municipality's forest

cheaper raw materials for lumber production, Capital Company's lumber production costs do not allow to obtain added value from the sawlog (roundwood) processing. In the view of the State Audit Office the participation of the Capital Company in a commercial activity — lumber production — does not comply with the requirements of the State Administration Structure Law and distorts competition, thus eligibility of Capital Company's lumber production costs were not assessed in detail. During the audit it was established that if the Capital Company sold the sawlogs (roundwood) obtained as a result of the Municipality's forest management to the commercial entities operating in the forest industry rather than carried out their processing, its profits in 2015 and 2016 would likely increase in total by more than 3 000 000 euros.

Since the Capital Company has also been entrusted with the management of Municipality's gardens and parks, for which a Municipality's subsidy and resources gained as a result of Municipality's commercial activities are allocated, the possible allocation of Capital Company's profits from the forest management to the management of gardens and parks could decrease the amount of the Municipality's subsidy, thus leaving the Municipality with more financial resources available for other needs of the citizens.

Also the procedure for granting the annual subsidy to the Capital Company for the management of gardens and parks in amount of almost 2 000 000 euros should be improved significantly, because the subsidy is granted without setting the exact amount of the work to be done and without follow-up quality control of the performed work. The audit established that, for example, in 2016 the Capital Company submitted an estimate of Municipality's garden and park management costs in amount of 5 051 313 euros, the Municipality granted a subsidy in amount of 1 931 888 euros, but the Capital Company planned in its budget for 2016 expenditures for this goal in amount of 2 748 100 euros. The current procedure for granting and supervision of the grant for the garden and park management does not give a clear picture of the work that the Municipality planned to do and the work that the Municipality granted the money for.

Main Recommendations

Based on the findings of the regulatory audit and our conclusions, we ask the Municipality in cooperation with the Capital Company to address the incompliance in the Municipality's forest management and performance of the tasks delegated to the Capital Company and to ensure:

- timely development of the forest management plan and control of its implementation;
- participation of the Capital Company in a commercial activity only in compliance with the requirements of the State Administration Structure Law;
- control over the performance of the management tasks delegated to the Capital Company;
- transparent financing of Municipality's gardens and parks, namely, separated accounting of respective expenses and traceable link between the financing and the tasks to be performed;
- setting criteria to determine the most advantageous way to perform the economic activity of the Capital Company to receive necessary services.



In order to address the deficiencies and incompliance established during the audit the Municipality together with the Capital Company should:

ensure timely development of the forest management plan and control of its implementation;

prevent the commercial activity which does not meet the requirements of the State Administration Structure Law;

ensure control over the financing of the Municipality's garden and park management.