

Abstract

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The procurement and commercial use of multipurpose icebreakers

Up to the early 1990s Finnish merchant shipping was assisted in winter by traditional icebreakers, which were designed and built only to break ice.

Owing to the lack of good open-sea characteristics, traditional icebreakers can only be used in winter. Since icebreakers are a very expensive investment, there was a need to develop a type of vessel which can also be used during the open-water months. On the basis of this development work three multipurpose icebreakers were built in the 1990s.

The Finnish Maritime Administration's goal of developing a multipurpose icebreaker is in itself commendable. Numerous improprieties and problems have arisen in procurement processes and the commercial use of vessels, however.

The first key question in the audit was whether it has been more economical for the state to procure multipurpose icebreakers rather than traditional icebreakers. The audit indicates that the answer is yes, although the difference between these alternatives has not been very large so far. If income from the commercial use of the first two multipurpose icebreakers, Fennica and Nordica, had remained according to the first time-charter contracts, which were concluded in 1991 and 1992, it would have been more economical for the state to procure traditional icebreakers instead of multipurpose icebreakers. The amount of income from the Fennica and Nordica rose considerably in 1998, when time-charter contracts were replaced by ship rental and maintenance charge contracts.

Evaluating profitability depends essentially on what interest rate and depreciation are used. According to the values used in the audit, 67% of the total costs of the Fennica and Nordica are capital costs. The figure for the third multipurpose icebreaker, the Botnica, is 56%, due to lower interest expenses. The Finnish Maritime Administration's profitability calculations show, for example, that the Fennica's commercial operations produced a net profit of FIM 3.0 million in 1993-1999. These calculations are based on the interest rates in State Treasury guidelines, which varied from 11.69% to 4.9% during this period, and on average depreciation of about 3.7%. For the purpose of the audit, calculations were prepared using the same average depreciation as in the Finnish Maritime Administration's calculations but different interest rates. If the average interest rates in State Treasury guidelines are used, the result is a loss of FIM 2.3 million in 1993-1999. If average interest according to State Treasury guidelines is calculated on the procurement price of all three vessels, the result is a loss of FIM 0.9 million. If we use the figure of FIM 62.7 million as additional procurement expenses resulting from commercial operations instead of the FIM 47.7 million used by the Finnish Maritime Administration, the result is a loss of FIM 26 million, and if other procurement expenses besides those resulting from commercial operations are applied to

commercial operations in relation to the number of service days, the loss from commercial operations is much larger.

Apportioning capital costs in this way is only theoretical, however, and this type of apportioning was not intended when the vessels were procured. In evaluating profitability figures one should take into consideration that, in determining icebreakers' total costs to the state, which include the total costs of icebreaking, the net costs to the state according to the calculations in the audit are higher for traditional icebreakers than for multipurpose icebreakers. In the comparison in the audit, the fact that the operating costs of traditional icebreakers would probably decline as a result of technical development has not been taken into consideration.

The second key question in the audit was whether the choice between traditional and multipurpose icebreakers was based on proper studies. The audit indicates that the answer is clearly no.

In connection with the procurement of the first two multipurpose icebreakers and in the early stage the third one as well, the comparison price for a traditional icebreaker was obtained by indexing the procurement price of an icebreaker procured in the 1980s with an index whose source is unknown. This index produced a clearly higher price than the shipbuilding index. Tentative offers were not requested for a traditional icebreaker in connection with any of the procurements. The comparison price used was FIM 25 million higher than the figure proposed by a working group which had been appointed by the Ministry of Trade and Industry to study the matter. This proposal was submitted nearly two months after the Cabinet Economic Policy Committee had come out in favour of the first multipurpose icebreaker.

The additional investment required to make an icebreaker multipurpose was sizably underestimated in the calculations for all three multipurpose icebreakers. This also applies to the calculations concerning multipurpose icebreakers' operating and capital costs. Both these calculations lack proper analyses.

The third key question in the audit is whether the most economical multipurpose icebreakers have been selected.

The first multipurpose icebreaker had the lowest procurement price. The second was procured on the basis of an option, in which case there is no need to request tenders under procurement rules. Since another reliable and competent supplier had asked for tenders to be invited, in the opinion of the State Audit Office, the Finnish Maritime Administration acted contrary to good practice in not informing decision-makers of the second supplier's willingness to submit a bid.

Payment for the third multipurpose icebreaker was largely up-front. The benefit of this to the supplier was greater than the difference between bids. Interest on up-front payments was not

taken into consideration in comparing bids as prescribed in regulations. Consequently the most economical option for the state was not selected. Furthermore, suppliers were not treated equally since the other bidder was not informed of the significance of up-front payments in payment terms.

With regard to commercial operations, the State Audit Office notes first of all that the Finnish Maritime Administration, without inviting tenders, selected a contract partner to which it chartered all the multipurpose icebreakers for the open-water months. It is true that the Finnish Maritime Administration surveyed possible contract partners through brokers before the first multipurpose icebreaker was procured. The Finnish Maritime Administration has not determined what would have been the best income level which could have been achieved by hiring or chartering the icebreakers, however.

Secondly, contracts with a Norwegian company concerning the commercial use of the multipurpose icebreakers were made for a fairly long period and were extended at an early stage. It is true that the Finnish Maritime Administration can cancel current contracts with a notice period of two to three years, depending on when notice is given.

According to contracts the income received by the Finnish Maritime Administration has consisted of two items, time-charter income or rent plus a bonus based on income received by the chartering or renting party from the use of the multipurpose icebreakers. Originally bonuses accounted for a larger part of the income received by the Finnish Maritime Administration, but the State Audit Office regards this change as positive.

In 1993-2001 the multipurpose icebreakers' utilization rate ranged from 82% to 87%, depending on the icebreaker. The utilization rate for traditional icebreakers has ranged from 15% to 38%. The period of commercial use according to contracts has been extended, but it was observed in the audit that, compared with traditional icebreakers, the multipurpose icebreakers have not generally been placed in use as late as possible. On the other hand their icebreaking period has ended earlier than that of other icebreakers. From autumn 1993 to spring 2001 there were four winters when multipurpose icebreakers were engaged in icebreaking even though one or as many as four traditional icebreakers were not in use. In the opinion of the State Audit Office, the amount of time in which the multipurpose icebreakers are in commercial use should be as long as possible.

Charter and rental contracts have been based on standard contracts, although these have been modified to some extent. The contracts have not been sufficiently precise and comprehensive in all respects, in addition to which some optional parts of standard contracts have been left open so that there is no way to know what has been agreed. The lack of precision also applies to points defining the grounds for calculating certain expense or income items. The audit also indicated that certain aspects of contracts have not been observed and that this has resulted in economic damage for the state.

The Finnish Maritime Administration has in many cases billed receivables late and receivables have also been paid late. If interest on overdue payments was calculated, in many cases the interest rate was lower than agreed in contracts. According to calculations based on the interest rates in contracts, this resulted in about FIM 12.7 million in lost income for the state up to the end of 2000. The Finnish Maritime Administration has also observed that the other party has failed to pay bills totalling about FIM 3 million. The Finnish Maritime Administration demanded payment from DSND Group at a court of arbitration in Denmark in 2001, but the matter has not yet been resolved. DSND Group also presented its own claims to the court of arbitration. The Finnish Maritime Administration is also demanding these receivables in a separate action against the officials who were responsible for the loss insofar as the Finnish Maritime Administration's demands are not met in arbitration proceedings.

The Finnish Maritime Administration has reported that receivables totalling about FIM 4 million were not billed in 1995-1999. According to the Finnish Maritime Administration these were billed in 2000. These receivables have also been paid almost in full.

Furthermore, in at least two cases the Finnish Maritime Administration has extended the interest-free payment period, resulting in a loss of about FIM 0.5 million for the state, calculated according to interest on overdue payments. The Finnish Maritime Administration also cancelled a receivable amounting to about FIM 0.7 million without justification. It systematically billed certain cost items later than prescribed in contracts.

The Finnish Maritime Administration accepted one major contract change which extended the payment periods which had originally been agreed. The extension was interest-bearing, but the result was a loss for the state of FIM 0.9 million compared with interest on overdue payments under the contract.

The Finnish Maritime Administration has announced that it is preparing a summary of other damages for which it will demand compensation from the appropriate officials in a separate action.

The first contracts and maintenance contract contained a stipulation according to which both parties can appoint an independent authorized auditor to audit accounts at any time during the contract period. The Finnish Maritime Administration did not exercise its right to appoint an auditor, at least up to the end of 2000, so it did not strive to ensure that the amounts which were paid and charged were correct. In the opinion of the State Audit Office, the Finnish Maritime Administration did not strive sufficiently to ensure the state's interests.

Although according to the rent contract part of the rent consisted of a bonus based on income received by the renting party, the rent contract did not contain a stipulation concerning the right to audit accounts. The State Audit Office considers this a deficiency.

The Finnish Maritime Administration's internal audit did not audit operating income and expenses for commercial activities, at least up to the end of 2000. The State Audit Office considers this contrary to the Decree on the State Budget, since commercial activities were fairly extensive and riskier than ordinary official activities. In 1999-2001 income from commercial activities amounted to about FIM 96 million or 16 million euros a year.

In the opinion of the State Audit Office, engaging in production and commercial activities through a government agency causes certain problems. Consequently the Finnish Maritime Administration's production and commercial activities should be separated from the agency's official tasks.