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French Accounting Chambers and Water Provision Management Audits

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Introduction

France has 26 Regional Accounting Chambers based in the 22 metropolitan regions, in two overseas regions West Indies Guyana and Reunion in the Indian Ocean and in the territories of New Caledonia and French Polynesia.

These institutions are in charge of the budgetary, financial and accounting controls carried out on local communities and public entities which have been vested with increased powers from the central state after a large decentralization movement initiated in 1982 by President François Mitterrand.

The Accounting Chambers are independent institutions which are made up of , 342 specialized magistrates who are geographically close to these communities and entities. They rule within their competence on all the accounts kept by public accountants of territorial communities and their public entities.

Their competence is mandatory and of common law whereas the control performed over the other organisms within the public field which receive public funds is optional.

The Court of Accounts based in Paris coordinates the actions of the Regional Accounting Chambers and is an appeal instance for the judgements pronounced against the public accountants by the Regional Accounting Chambers, (25000 judgments per year) .

The law confers to the Regional Accounting Chambers three types of investigating powers, and specifies that they should take all the necessary measures to assure the secrecy of the investigations.

They have the right to ask for all the documents they deem necessary for the investigations, it is a wide power and concerns all the documents relating to the territorial communities which are subject to the control of the Chambers.

They have the right to hear, it allows the hearing of any public official, representative ,administrator, public officer, member of the inspection or control department if necessary.

These persons are bound to comply with the summons of the Chamber and are released from professional secrecy while answering. A refusal to answer questions or produce documents can be punished by a fine (maximum amount 150. 000 €).

The right to investigate which means the right to ask all the questions generated by the investigations, the Chamber may also have recourse to experts appointed by the Chamber's President to carry out investigations in highly specialized fields. These powers can be used indistinctly in all tasks entrusted to the Chambers.

In France water provision and the management of water networks is a communal competence. The 36785 French communal entities (Communes) have a choice between three types of management.

They can manage the water service themselves and thus keep the complete control of the network's exploitation or delegate the management responsibility to the private sector in a Public Private Partnership. In this case they can choose between renting the network or a public service concession.

In the first case the commune decides, finances and builds the equipments, and the private company runs the water service at its own risks. The customer is charged with a rental tax which is due to the commune and will serve to finance the investments and a price which, remunerates the company for running the service.

In the second case, (PPP) the water company is responsible for building, financing and running the water service at its own risks. The duration of the contract between the commune and the company is based on the duration of the depreciation of the equipments financed by the company which is fully responsible for the good working order of the network and is paid by the customer through an annual fee. It is commonly admitted that contracts should not last longer than 20 years. The average duration is 12 years

In France nowadays, 75 % of water provision is provided by private companies designated after a public competition, mainly through renting contracts, the remaining 25 % is run by the communes.

The three main private companies are Veolia, Suez Lyonnaise des Eaux and Saur International which is a subsidiary of Bouygues Public Works Company.

In the 90's water companies have been associated with mismanagement and corruption scandals which have led the legislator to enact stricter laws to protect the communes and the customers interests.

These laws have also given the Accounting Chambers extended powers to control the accuracy of annual accounts submitted by the companies to the communes; including the right to control the companies own accounts.

The communes are audited by the Accounting Chambers every four to six years; water provision contracts are always included in the audits (700 per year including private entities receiving public funds such as associations and semi public companies). They are regularity and financial audits not performance audits.

I will successively present the audit procedures followed by the Accounting Chambers, the controls of the Public Private Partnerships contracts, in France it corresponds to public service concessions. The controls of the execution of these contracts by the private companies, and will end with a few recommendations the Chambers have made to the communes to improve the water service quality.

1/ Audit Procedures

In the first stage of the audit process a global review of the entity to be audited is carried out; after the collection of data.

The Audit of a Public Private Partnership in the water provision field is conducted on the basis of the following documents (of the previous four or six years) which must be in the commune ' s possession and the private company in charge of the audited water network:

- * The contract signed between the commune and the water company and the amendments
- *The annual financial reports of the proxy to the commune
- *The proxy's annual reports of the network's renewal operations
- * The annual reports on the price of water
- * Special reports established by specialized audit cabinets
- * The proxy's projected exploitation reports
- * The communal water budgets .

On the basis of this data, the auditor in charge elaborates the planning memorandum.

The second stage consists of elaborating specific programmes for each area of the audit work. These working programmes generally include three sections:

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Audit objectives
Audit procedures.

The third stage of the audit process consists in carrying out the different audit tests and procedures which are included in the working program. The audit includes written questionnaires , interviews and the examination of the proxy' s accounts and the supporting documents .

During this stage the evidence of a sufficient, significant and reliable audit is obtained with the purpose of achieving a reasonable basis on which conclusions, comments and recommendations are soundly grounded.

Everything stated above is recorded in a complete and detailed file of the work which has been done as well as the conclusions which have been reached. The file includes all the working papers.

Basically, the implementation of working programmes is carried out by the audit councillors with the help of audit assistants. A well conducted audit should not take more than a few weeks.

The audit work is fulfilled in such a way that the opinion of auditors is continually compared with the opinion of the individuals in charge of the audited entity which can be time consuming. During the audit , opinions are exchanged and provisional conclusions are reported to the audited entity.

The fourth stage consists in preparing the draft report by the auditor in charge. Once the draft report is established, it is approved by the council of the accounting chamber and is referred to the commune and the audited entity so that they may submit allegations. The final report is prepared with the aforementioned allegations .The report is approved again by the council of the accounting chamber.

The addressees of these reports are the deliberating assembly of the local community and the board of directors of the audited corporation. After this stage the audit report becomes a public document and is accessible to the public. A few of them are also published every year in the Court of Accounts annual public report.

2/ The control of the contract's provisions

The contract's contents should in theory be the result of negotiations between the commune and the private water company, but it implies that the commune has the qualified staff to defend its interests (lawyers , accountants , financiers) which is most often not the case. It means that a great majority of the contracts are not really negotiated and the relationship is unbalanced.

That's the reason why the audits frequently reveal that the interests of the communes and the water customers are not properly protected. The contract's provisions often lead to price increases which are not really justified by any service.

The most frequent questionable provisions found in the contracts are the following:

2.1 The unadjusted revision provisions

All the contracts include revision provisions which allow the revision of the initial price every year until the end of the delegation. The revision formula can in some cases lead to an increase in the price disconnected from the reality of the company's costs.

For instance the proportion of the salaries charges can exceed 50% in the revision formula whereas they in fact only represent no more than 25 % of the recorded costs. In such a case this provision should be amended and the revision formula established on a more realistic basis.

2.2 The provisions protecting the company against any fall of profits.

It may happen that during a contract, water consumption decreases especially in large cities who pursue a policy of sustainable development which have a direct impact on water consumption, this reduction represents a serious risk for the company .

Some of them manage to include in the contracts special provisions which protect them against such a risk, usually a price increase in case the water quantities sold would diminish . Such a provision is unacceptable since the company has signed to manage the network at its own risks .

2.3 The special fees paid by the companies

In some cases the commune has asked the company to pay a special fee (entry fee) or public domain occupation fee, at the beginning of the contract. It gives the commune extra money to finance other projects unrelated to the water provision service but leads the company to pass the cost on to the customer which is not acceptable.

This practice has been officially forbidden in France since 1995, but is still discovered nowadays under different names such as special contributions.

Once the audit conclusions are definitive, the commune has always the ability to ask for amendments to the contract to ensure a better balance between public and private interests .

3 / The control of the contract's execution by the private companies

The annual report must be accurate that is to say , its content must reflect the reality of the companies operations .It must be presented in the same manner every year to allow comparisons with the previous accounting years.

It often happens that the informations given do not allow the commune to understand what the company has done during the past year.

The audits carried out during the last five years in France have revealed the following anomalies:

3.1 The undue direct costs

Sometimes the water companies include in the concession charges, expenditures which are irrelevant to the water service such as sponsoring or advertising expenses, company development expenditures .

.It also happens that the company is invited by the commune to carry out alteration works which are not related to the water network, that is the case when the water company is a subsidiary of a large public works company. The water customer thus pays undue charges.

3.2 The unallocated costs

The proxy registers in its accounts indirect costs as well as costs which are in fact related to other delegations run by the company. In some delegations the indirect costs are more important than the direct costs and can represent up to 80% of the total costs. These indirect costs do not always match with identified services .

This is the case with central siege costs which are included in the costs whereas they do not concern the company itself but the group to which it belongs .The central group justifies these costs by referring to accounting, human resources, expertise costs .They are often determined on an inclusive basis which means that the company is in fact unable to justify them precisely when asked.

Sometimes these indirect costs are based on accounting expertise dating back to previous years and in some cases before the contract has been signed.

It means that the delegation and the water customer bear costs which should not be included in the charges. This situation is regularly denounced by the Accounting Chambers but the truth is that they haven't yet managed to put a complete end to this doubtful practice. Its up to the communes to check the reality of these charges in the first instance.

3.3 The replacement costs

The company has the duty to keep the water network in good working order, which means that the necessary alteration, renewal and maintenance works have to be carried out every year, used pipes and meters have to be replaced regularly .

The company includes every year in its costs interim payments for maintenance, which are funds put aside to cover future maintenance expenditures.

In fact the replacement rate can be very low in some cases, it is not unusual to see a 1 % replacement rate of pipes, which means that it takes almost a century to renew the whole network .This situation is not acceptable. The proxy must be able to justify every year the exact amount of money it has spent to maintain the water network in good working order according to a previously established plan. It implies that the commune has established in the first instance a detailed inventory of its water network (length of pipes and their locations , number, age and locations of the water meters) before signing the delegation contract which is not always the case.

If the maintenance works are not carried out regularly, it means that the company is not fulfilling its obligations properly and is also making undue profits .

It's up to the commune to check every year that the interim payments are really used. For instance in the city of Lyon (second largest city in France) , it has been established that after nine years only 41.5 M € of the renewal interim payments had been used in maintenance works whereas the interim period payments during the same period amounted to 87 M € . In this case the renewal charges were partly fictitious and water price was higher than it should have been.

In some contracts the companies have managed to include a renewal guaranty provision which is in fact a kind of insurance provision meaning that maintenance works will be carried out only in case of necessity and not on a regular basis , moreover this maintenance works will be often carried out by a subsidiary of the company .

This kind of provision is unacceptable because it leads to unjustified profits for the company which are not found in their accounts and also a badly maintained network.

3.4 The uncharged profits

It may happen that some of the company's profits although they are related to the contract are either omitted or underestimated by the proxy; such a practice can contribute to diminish the real profits of the delegation and can lead the commune to believe that the results are different from the reality.

This is often the case with financial profits derived from the temporary investment of the rental tax or other taxes collected by the proxy on the customer but which it has to pay back to the commune or other public authorities (environment agencies)usually three months after the collection but which it keeps sometimes several months.

The financial gains derived from the investment are unregistered in the delegation's accounts and unknown to the commune.

This practice can generate significant financial gains when the company manages several contracts .

These profits can be traced only by investigations in the company' accounts which are accessible to the Accounting Chambers. With such a practice the companies' profit margins can easily reach 12 to 15 % instead of the 5 % they usually announce.

3.5 The end of the contract's provisions

The provisions relative to the end of the contract are often inaccurate, the fate of the equipments which are not fully depreciated used for running the network such as water meters, water pipes as well as the employees future (the eventual compensations due by the commune to the company to cover redundancies and pensions due to the employees) is not always included in the provisions .

They can sometimes represent hefty sums which the commune will have to pay at the end of the contract.

The commune should know well in advance about these eventual expenditures so as to include them in its budget.

The commune should also care to recover the customers 'files from the company to be able to run the service effectively once the contract is finished.

4 Recommendations.

The audits of the public private partnerships conducted over the last five years by the French Accounting Chambers have lead to the following recommendations:

* The communes must insist on the improvement of the accounts presented every year by their proxies. They have the right to ask for amendments to the contracts, especially when the duration of the contract is long, every time it appears that their interests are not properly protected, it is also in the customers interests to do so.

Badly or poorly managed water delegations should be cancelled when improvement demands are not met.

*The communes should take care to set up an inventory of their water service before any delegation is signed, it would really prevent being cheated by their private partners.

* The communes should adopt performance indicators which would serve to measure the quality of the service delivered by the proxy.

The suggested indicators are the following:

*Quality of the drinkable water. (% of analysis in accordance with the norm)

*Continuity and security of the water service (water cuts / 1000 consumers), (% of water leaks)

*Maintenance and durability of the water network (% of pipes replaced every year), (medium rate of pipes replacement)

*Economic and financial management of the delegation (price of water / metric cube) , % of unpaid bills)

*Relations with the customers (global rate of written complaints).

Conclusion

I would like to stress that water is a precious and scarce resource which will become scarcer in the future. We in the Northern Hemisphere are lucky enough to have it a plenty, we thus have the duty to ensure that this resource is preserved and well managed for the benefit of our populations.

I believe that the control authorities to which we all belong have a central role to play to achieve this goal.

Thank you very much for your kind attention.