



AUDIT
OFFICE



REPUBLIC
OF CYPRUS

MINISTRY OF TRANSPORT, COMMUNICATIONS AND WORKS

Executive Summary



AUDIT OFFICE OF THE REPUBLIC
SPECIAL REPORT no. YMEE/01/2022

5 September 2022



AUDIT
OFFICE



REPUBLIC
OF CYPRUS

MINISTRY OF TRANSPORT, COMMUNICATIONS AND WORKS

Executive Summary

AUDITED ENTITY

Ministry of Transport, Communications and Works

Executive Summary

In accordance with the provisions of article 116 of the Constitution of the Republic of Cyprus and of article 81 of the Fiscal Responsibility and the Fiscal Framework Law (20(I)/2014), the Audit Office performed an audit on a sample of transactions of receipts and payments of the Ministry of Transport, Communications and Works for the year 2020, which was selected by using a specific methodology, for the purpose of expressing an audit opinion on the financial statements of the Republic of Cyprus. We also conducted a compliance audit for the years 2019-2020 and investigated Public Procurement issues.

Additionally, we have performed an audit on a sample of tender documents of the Ministry of Transport, Communications and Works and its Departments, which were selected on the basis of a specific methodology, and an audit on the award and execution of public contracts, in accordance with the provisions of the Public Procurement legislation, as well as an audit of the Information Systems.

The most important audit findings, are summarized as follows:

1.1 Management

a. Concession Agreement for the Development and Management of Larnaka and Pafos Airports

- ◆ The negotiation process between the ad-hoc Committee appointed by the MTCW and the company which is the Contractor of the Concession Agreement, resulted in a preliminary agreement for the company's compensation, due to the operation of the illegal Tymvou airport, with an amount of €23 million for the period 2015-2017, which has been accepted by the Ministry of Finance. Our Office considered the amount as unjustifiably high and not in accordance with the Concession Agreement terms, and stated its position regarding the number of passengers who use the illegal airport that should be taken into account when calculating the compensation costs, thus standing in favor of the rejection of the above mentioned proposal of MTCW in the relevant meeting of the Central Committee on Changes and Claims (KEAA). The issue is pending in KEAA since 2017, while awaiting legal advice by the Law Office of the Republic. The company, without having the MTCW's consent, is withholding an amount of more than €43 million for the period 2015-2019.
- ◆ Based on the growth of the rate of passengers, provided by the Concession Agreement, the company should have proceeded to the second phase of the development works at Larnaca and Paphos Airports. The company, however, suspended the works despite the MTCW's disagreement. The Fast Dispute Resolution Panel judged in favor of the MTCW, while the Ministry and the company started negotiations regarding the implementation of the second phase development works, reaching a preliminary agreement for 5,5 year extension period of the Concession Agreement.
- ◆ The Contractor claimed that due to an incorrect practice it had been applying for many years, made overpayments regarding the variable Concession Fee totaling €15million, and unilaterally proceeded to deduct this amount in 2018, which caused the objection of the Ministry of Transport, Communications and Works, which requested the legal opinion of the Law Office of

the Republic. According to that opinion, the Contractor has violated its contractual obligations which deprive it from the right to claim a refund of the amounts it considers to have been overpaid to the Ministry of Transport, Communications and Works.

- ◆ Due to omissions and/or delays in the handling of the contract for carrying out Covid19 laboratory tests at Larnaca and Pafos Airports by the Department of Civil Aviation (DCA) , there was the oxymoron phenomenon that two Ministries of the Government assigned the same services for the same period of time to the same Contractor, at prices that differed significantly from each other, , with the prices contracted by the Ministry of Transport, Communication and Works (MTCW) being higher by approximately 80% and 53% per airport respectively, than the corresponding prices contracted by the Ministry of Health. In addition , after contract signing, it was deemed necessary to post-approve a 50% extension of the duration of the awarded existing contract , with the contracted prices being much higher than the ones offered in a separate new tender by the same Contractor, under competitive conditions and not of a monopoly.

b. Privatisation of the commercial activities of the Limassol Port

- ◆ A disagreement arose between the Ministry of Transport, Communications and Works and the Cyprus Ports Authority (CPA) regarding the adjustment of the annual fee paid to CPA every year, resulting in CPA's claim from the Ministry of Transport, Communications and Works for an amount of €1,602,544 for the years 2017-2020.

Concession Agreement for the operation of the Multi- purpose and Passenger Terminal

- ◆ During the years 2019 and 2020, the Port Development team did not perform an audit of the non-regulated tariffs imposed by the Contractor, in order to confirm that they conform with the percentages that are set out in the Concession Agreement.
- ◆ There is a disagreement between the Contractor and the Ministry of Transport, Communications and Works over the maximum amount (ceiling tariff) for the "International Ship and Port Facility Security Code" (ISPS) security system.
- ◆ The arbitration by the International Chamber of Commerce (ICC) following a request for arbitration by the legal representatives of the Contractor, regarding a dispute regarding the Concession Agreement for an area that is adjacent to the Administration building of the CPA used as a car park for its staff and visitors, and a dispute about the limit of the annual cargo at Larnaca port, has not been concluded as at the date of this report.
- ◆ We have identified that the Contractor was unable to meet the working capital requirements shortly after the undertaking of the Terminal operations (29.1.2017) and had to see credit facilities from its parent company.
- ◆ There is a significant delay by the Law Office of the Republic in providing legal advice to the Port Development team, resulting problems in applying the Concession Agreement.

Concession Agreement for the operation of the Container Terminal

- ◆ The Contractor claimed an amount of €306,096 (including the Concession Fee) for the years 2017-2019, as well as for future years, from the Customs and Excise Department for the area at the Limassol port taken up for the use of the motorized radio-diagnostic system of containers.
- ◆ Despite the obligation to serve the carriers in less than 90 minutes, the Container Terminal Operator decided unilaterally to serve the cargo carriers, initially, in 11-20 minutes and then increased the service time to 25-35 minutes, with an intention to further increase it to 30-45 minutes for cost saving. The decision to increase the service time, although it was still under 90 minutes, caused the carriers' intense reaction, who proceeded to a warning stoppage. The Ministry, under the threat of strikes by the carriers and to avoid national financial consequences, suggested to KEAA to adapt a new regulated tariff for carriers' fast service with the variable concession fee paid to the State, set to zero. KEAA, while at first rejected the Ministry's proposal, finally approved it. Our Office has repeatedly expressed its strong disagreement to any amendments to the Concession Agreement essential terms, pointing out that any satisfaction of the Operator's demands, to cover the additional cost in order to restore the service time to 11-20 minutes, will constitute a precedent for similar actions in the future that would force the Contracting Authority to take decisions that are against contractual terms and against the public interest.
- ◆ Central Committee on Changes and Claims (CCCC) approved Executive Board on Concession Projects' (EBCP) proposal for the establishment of a subsidiary company by the Limassol Port Container Terminal Operator, which will operate as a Revenue Subcontractor for the development of transshipment, and the reduction of the variable concession fee (percentage on gross revenues) paid to the State from 62,71%, as specified in the Concession Agreement, to 3,5–5% depending on the number of cargo movements, plus a profit sharing mechanism when the Internal Rate of Return (IRR) exceeds 12%. The Law Office of the Republic, in their legal advices, pointed out to the Ministry that the Operator may subcontract some of its privileges or rights under the Concession Agreement with the prior written consent of the State, however, the Operator's subsidiary is an entity of his ownership, thus this action is a specious way of evading his obligation to pay the contractual variable concession fee. Furthermore, the Ministry's' Project Team expressed its concerns that this action may constitute a precedent for further exceptions on the Operator's contractual obligations regarding the Port activities.

Taking into consideration that the Concession Agreement includes a term that clearly states that the establishment of a Revenue Subcontractor must neither adversely affect nor likely to adversely affect the variable concession fee payable to the State, our Office disagreed with CCCC's decision, pointing out that the Operator should proceed to a call for tenders to assign the transshipment to a Revenue Subcontractor, excluding himself, as otherwise he will benefit from profits against the Concession Agreement terms, and the variable concession fee will be negatively affected. We also disagreed with the opinion expressed by both the EBCP and the Ministry of Finance that the amendment of certain Concession Agreement terms in order to implement the

agreement for the development of transshipment, according to the Law 11(I)/2017, is not of the essence, because it affects the financial balance of the Concession Agreement in favor of the Concessionaire in a way that was not foreseen in the initial Agreement. Our Office informed the Commissioner for State Aid Control asking for her opinion on whether these decisions constitute state aid or not, and expressing the intention to request guidance from the European Commission regarding the permissible amendments on public contracts based on the EU Directive.

Development of the Larnaka Port and Marina area

- ◆ A payment was made by the Ministry of Transport, Communications and Works to the Cyprus Ports Authority on 20.12.2017, for an amount of €478,793 regarding the provision of consulting services for the Larnaka port and Marina development project, which was in violation of the Budget Law for 2017 and the Accounting and Fiscal Management and Financial Control Law of the Republic Law.

Provision of Scheduled Public Passenger Transport Services with the use of buses to cover all areas under the effective control of the Republic of Cyprus

- ◆ The 2010-2020 concession contracts for the public transport services for the Districts of Nicosia, Limassol, Larnaca, Paphos and Famagusta and the intercity routes expired in early July of 2020. The Ministry ignored our repeated warnings that it should proceed on time (at least two years prior the contracts' expiration) a new call for tenders for the contracts of the 2020-2030 decade, and showed negligence by announcing the call just one year before the contracts' expiration and by setting the deadline for the submission of tenders in late October of 2019. While the contracts for the Districts of Nicosia and Larnaca were signed on time, the Ministry extended the remaining four contracts with the current Contractors, due to the legal recourses taken by tenderers and the overturning court decisions. The Ministry showed even more negligence in the new call for tenders for the Districts of Limassol and Paphos. The tender for the District of Limassol was completed with the signing of a new contract in 4.7.2022, i.e., the expiry date of the maximum two-year extension provided by the Regulation (EC) 1370/2007, while the contract signing for Paphos District is still pending. As an intermediate solution and due to the fact that a further (beyond the two-years) extension of the current contract for Paphos District is prohibited, the Ministry illegally, in our opinion, signed an agreement with the Famagusta District Contractor, who uses the Paphos District Contractor as a subcontractor. Our Office pointed out that the Ministry through an intermediary (Famagusta District Contractor) tried to show that the agreement was awarded by an open tender procedure, but in practice, the services will continue to be provided by the same company. Taking into consideration that, during the summer months, the Contractor's income was higher and therefore the state sponsorship was significantly reduced, while now (at least until 31.8.2022) he will be paid a fixed rate of €1.30 per km, there is obviously a need to further investigate additional aspects of the agreement.
- ◆ The Ministry's audit on the audited financial statements of the Nicosia District Contractor for the 2010-2020 decade, showed discrepancies in the amount owed to the Contractor, which resulted in a negotiation process between the two parties to reach a friendly settlement. As a result of this

settlement, the Ministry accepted that the Contractor's contractual obligation to pay an amount based on advertising revenues, would be reduced by approximately €1,6 million. Our Office expressed its concern about the fact that the Ministry did not take into consideration, that the Contractor had already benefited from an amount of approximately €2,3 million, which is the residual value of the bus fleet bought by the Contractor in 2010 and remained in his ownership, although it was 100% redeemed by the Ministry. The Office of the Commissioner for State Aid Control and the Law Office of the Republic, raised an issue of amendments to essential contract terms, in favor of the Contractor, agreed with our Office's position that the fact the Contractor benefited with the residual value of the bus fleet should be taken into consideration along with other contract's provisions and came to the conclusion that the friendly settlement differs from the market economy operator principle, thus it constitutes an illegal state aid.

Support Scheme for Small Television Stations broadcasting through the Digital Terrestrial Television Network

During the years 2019 and 2020 the Ministry of Transport, Communications and Works sponsored two television stations C and E , not taking into account the family relationship between Mr AA (director of the company CD, owner of television station C) and Mr BB (shareholder and director of the company EZ, owner of television station E), which indicates the existence of "affiliated undertakings" for which sponsorship is prohibited.

1.2 Public Works Department (PWD)

- ◆ We observed weaknesses by the PWD in management/implementation of a number of projects, at the design stage as well as at the execution stage, which resulted in completion delays. Some of the most important projects included in our audit scope, were the construction of the New Highway Paphos – Polis Chrysochous, the construction of the New Cyprus Museum in Nicosia, the New Parliament Building, the extension of Larnaca General Hospital and the Conversion of the "Philoxenia" Building to a Court House.
- ◆ The measures taken by the PWD, for the compliance/responsiveness of the contractors to their contractual obligations, were not always appropriate and/or effective.
- ◆ The PWD in some cases did not handle delay issues in a timely manner, and failed to notify Contractors for their slow progress of executing the works.
- ◆ The PWD did not prepare interim valuation reports for Contractor effectiveness, nor proceeded with contract termination for all the cases where Contractors repeatedly did not respond to their contract obligations.
- ◆ Cases have been noted where the PWD did not examine all the possible methods for implementation of projects in order to choose the most suitable method, so to avoid problems, unnecessary expenses and delays.
- ◆ The PWD included in some contract document certain qualifying requirements, which possibly did not ensure enough participation, and as a result not endorsing healthy competition.

1.3 Department of Electromechanical Services

- ◆ The contract for the installation of the mobile phone disabling system in the Central Prison establishments, worth €1.202.714+VAT and with a duration of just 16 weeks, which was described as of the highest security for its installation site, was completed and the system was finally accepted with a 21 month delay, due to deviations of the installed system from contract requirements during various testing attempts as well as due to poor contract management by the Department. In addition, just 16 months after system acceptance, it became necessary to upgrade it, at an additional cost of €741.596 + VAT, which although it related to an important system parameter affecting its effectiveness and related to important security issues, the contractual execution period has passed without having been executed until the preparation of this Report.
- ◆ After the termination of the contract for the installation of a Traffic Law Enforcement Camera System in 2007, a new contract was signed 13 years later, a time too long for a system that is being considered by its user (the Police Force) to be of the highest importance for road safety, while the relevant laws for its implementation were approved after the contract signing date.
- ◆ In October 2015, the Department purchased two electric vehicles for the total amount of €44.660+VAT, which by September 2021, almost 6 years later, had traveled only 8.300 km and 8.400 kilometers respectively, which didn't allow drawing conclusions about the use of electric vehicles in Cyprus and the consequent awareness of the citizens, which was also the purpose of their purchase and use by the Public Service, while the investment made in electric vehicles with increased cost, compared to conventional ones has not been sufficiently exploited.
- ◆ In 2004, the Department purchased incinerators for the Larnaca and Pafos airports, for the burning/incineration of waste from building facilities and aircrafts, for a total cost of €2.299.273, which, however, could not operate, due to the lack of the necessary permits for this purpose.
- ◆ While an appeal had been filed with the Tender Review Authority, against the procurement process for the supply of oxygen production units for medical use in public hospitals, the Department proceeded to unseal the only one tender submitted. A year later, the Tender Board rejected the single tender, which was 81,7% higher than the estimated cost, because the tenderer had not renewed the tender participation guarantee.
- ◆ While the Tender Board had awarded a tender for the maintenance of elevators in October 2020, the successful tenderer failed to proceed to sign the contract, despite the Department granting two extension periods, resulting in the expiry of the validity of the tenders. Six months later, the Tender Board cancelled the aforementioned tender, without any penalties to the tenderer, since the Department did not ensure that, as it should, the tenders were kept in force.
- ◆ There was an 11th month delay in signing the contract for the 5-year preventive and corrective maintenance of the electronic sirens system of the Department of Cyprus Civil Defense worth €444.000+VAT. During the period between November 2019 and July 2020, when there was no contract in place, an amount of €20.655+VAT was spent for the maintenance of the sirens system,

which raises concerns about the reasonableness of the total cost of the five-year maintenance contract .

- ◆ While the Pafos General Hospital Management assigned the project for the replacement of the old nurse call system and medical consoles, as a project of highest importance with an approved budget of €550.000 in the 2019 budget, the contract was finally signed in July of 2021 for the amount of €525.462+VAT, due to the inability of the Department to implement the project within 2019, citing its understaffing.

1.4 Department of Road Transport (RTD)

- ◆ From the audit of the competition for the upgrade/change of current subsystems, development of new subsystems and guarantee/maintenance and support of TOMIS system we noticed weakness in identifying and recording of user requirements and the preparation of the tender documents, which should include measurable data.
Auditing the process of vehicle registration in TOMIS IT system we noticed weakness in process controls, as well as data validity controls.

1.5 Department of Postal Services (DPS)

- ◆ Findings of the Department's information systems audit included weaknesses in the systems' operation procedures and the IT control environment. Issues about the control environment were found which affected the governance and IT management, change management procedures as well as weaknesses in controls regarding physical security, access rights, network security and business continuity.
- ◆ We noticed that there was no reconciliation mechanism between the revenue amounts of the Integrated Financial Management System of the Treasury of the Republic (FIMAS) and the "ZENON – SAP" accounting system, either on a regular basis or at the end of the year.
- ◆ The Statement of Arrears of Revenues as at 31.12.2019, did not include the debit balances that appear in the "ZENON – SAP" system.
- ◆ Bank balance reconciliations were carried out with a long delay, up to 255 days after the end of the reporting period.