



*Supervision of and reporting on public-private arrangements*

## **Public entrepreneurship**



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## Summary

### Content and purpose of the audit

In 2004 the Netherlands Court of Audit performed an audit of organisations combining public-sector tasks and public funding with private-sector activities and private funding. The audit focused on five points: *standards, operational management, added value, reporting and supervision*.

The Court of Audit investigated the standards for public-private arrangements currently enshrined in primary and secondary legislation and in recent industry codes of conduct. It also looked at three sectors in particular and examined the extent to which reporting and supervisory arrangements within them reveal the nature, scale, associated risks and added benefits of private-sector activities and flows of private finance. In addition, the Court of Audit focused on three individual institutions and investigated their motives for entering into public-private arrangements, the administrative and organisational form of the arrangements concerned, and the risks associated with them. Finally, the audit included an assessment of whether, in the three organisations concerned, public-private arrangements are producing added value and, if so, for whom.

The audit addresses the following sectors: adult and vocational education, university medical centres (UMCs) and the knowledge and innovation sector. Within these sectors, it focuses on three individual organisations: the Regional Training Centre for the Central Netherlands (ROC MN), Leiden University Medical Centre (LUMC) and TNO (specifically, TNO Nutrition and Food Research).<sup>1</sup> These case studies are intended to cast light on general themes and dilemmas concerning public-private arrangements and not to pass judgment on the individual organisations. The conclusions and recommendations are formulated at a supra-organisational level. The audit is intended to inventory the present position, identify the problems and formulate the issues.

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<sup>1</sup> TNO: Netherlands Organisation for Applied Scientific Research.



The Court of Audit hopes that this report will be of assistance in the establishment of a regulatory framework for organisations which combine public-sector tasks and funding with private-sector activities and finance. In addition, it hopes that it will provide a firmer empirical basis for the current discussion concerning the desirability and feasibility of public-private arrangements, and hence of entrepreneurial behaviour in the public sector.

### **Nature and scale of public-private arrangements**

The three types of organisation considered in the audit engage in different kinds of public-private arrangements. Regional Training Centres (ROCs) engage in private contract teaching alongside the publicly funded education and training that is their main task. The UMCs' main hybrid activities are contract teaching and research funded (at least in part) by third parties. TNO runs research projects with mixed public-private funding, privatises independently viable parts of its organisation, and sells patents and licensing agreements.

In the three individual organisations audited, there is considerable variation in the amount of private income and the proportion it forms of total revenues: the ROC MN derives around €10.2 million of its income from contract activities (7.2% of the total). The LUMC receives about €20 million from private-sector clients (around 5% of its total turnover). TNO earns almost €300 million a year from contracts won in competition with its rivals (approximately 50% of its overall income).

### **Standards**

The Court of Audit conducted a survey of the standards for public-private arrangements. Some of these are enshrined in primary and secondary legislation, while others are contained in industry codes of conduct and advisory reports.

The results of the analysis of these documents suggest that little has yet been done to codify standards for public-private arrangements. A number of general legislative changes are still in progress (including the introduction of statutory rules for public bodies operating in the private sector and the EU's draft Services Directive). The sectoral legislation provides scope for public-private arrangements, but the intended benefits (i.e. added value) are not always clear. The industry codes do give general guidance on the internal governance and external accountability



of 'public enterprises', but pay little attention to the issues of operational management and added value.

### **Operational management**

The audit of the three organisations produced a varied picture. In all three, there is in theory – and largely in practice – an administrative separation between public and private-sector funds in the parts of the organisations audited.

In all three, however, cost accounting is deficient in certain respects. This creates a risk of cross-subsidisation of private-sector activities by public funds. In the case of the LUMC and ROC MN, the amount of money potentially involved is small, given the relatively modest extent of the organisations' contract activities.

The ROC's contract activities are not yet firmly embedded within the institution. As a result, the risk of a leakage of public funds and adverse effects on the institution's public-sector task cannot be ruled out. However, a complete reorganisation of the ROC's contract activities is currently taking place.

The LUMC is taking a number of measures to deal with the risks associated with contract activities. Its cost-attribution and pricing procedures are transparent, but there is a lack of consistency in the charging of staff costs. Also, licence management needs to be improved.

In the case of TNO, the aspects of operational management examined in the audit are generally in order. However, there is room for improvement as regards knowledge management and the cofinancing of projects, for example in the procedures for setting the 'market price' and in licence management.

### **Added value**

The Court of Audit looked at whether public-private arrangements offer added value in practice. It is critical of the fact that policy documents and advisory reports employ no clear definition of added value. It concludes that, although the public-private arrangements do produce added value in a number of respects, the results do not always come up to expectations.

Except as regards their financial benefits, institutions provide little or no information on the added value of their private-sector activities and



private funding. There is nothing to prevent them from reporting on these matters, since there are certainly credible and demonstrable examples.

Within the organisations, the audit revealed procedures and rules intended to secure the added value of research findings for society. There are also moves to develop societal impact indicators. However, the organisations' reports contain almost no information about this kind of added value.

### **Annual reports and accounts**

The analysis of the annual reports shows that, although the organisations do provide some information and figures on their public-private arrangements in their published annual reports and annual financial statements, the amount of information and the level of detail vary.

The information published in the annual reports of the organisations involved in the audit is not sufficient to justify any conclusion as to whether their public-private arrangements contribute to a beneficial cross-fertilisation between the public and private sectors. Their annual financial statements and annual reports proved to contain very little explicit information about the potential added value and risks of public-private arrangements.

The general impression is that internal reports provide more detailed information about the nature, extent and financial results of public-private arrangements than external reports, but that even internal reporting systems are not designed to provide information on the added value and risks of public-private arrangements (or on ways of dealing with these risks).

### **Supervision**

#### *External supervision*

Government has given institutions the freedom to develop public-private arrangements, but has failed to create a clear system for the supervision of such arrangements. The Ministry of Education, Culture and Science's 'Clarity' memoranda on adult and vocational education and higher education are a first step in the direction of extending its supervisory arrangements to include public-private arrangements and compliance with primary and secondary legislation concerning the use of public funds to finance private-sector activities. Actual supervision is marginal and



sporadic in the case of institutions of adult and vocational education and completely absent in the case of the UMCs. Where the performance of TNO and the LUMC are concerned, vertical supervision is supplemented by other forms of external assessment, such as benchmarking studies, peer reviews and various societal impact assessments. However, none of these reveal whether public-private arrangements contribute to the institutions' performance, and if so, how.

#### *Internal supervision*

The audit shows that, in practice, the supervisory boards of the organisations involved are alert to potential problems and receive the right information. In every case, however, the statutory basis or arrangements for the powers and responsibilities of the supervisory board proved to be inadequate. This is not a problem so long as things go well, but could become one if supervisory boards fail to do their job.

#### *Relationship between external and internal supervision*

In all three sectors involved in the audit, the minister is informed about the activities of the supervisory boards via the institutions' annual reports. However, this information gives the minister only a limited idea of how well each supervisory board is performing. In all three sectors, the role played by the supervisory board within the chain of supervisory responsibilities needs to be clarified. In particular, the division of roles and responsibilities between external and internal supervisory bodies could be more clear-cut. At present, the minister makes no use of the results of the work of the supervisory boards in her own external supervision of the sectors included in the audit.

### **Conclusions**

The extent of public-private arrangements varies from one institution to another, as does the freedom of choice available to individual institutions. In a number of respects, the organisations audited have made a credible case for the added value of such arrangements. At the same time, it is not always clear what criteria are used either by the ministries or by the organisations themselves to assess the rationale for public-private arrangements or their structure and performance. Operational management is still deficient in a number of respects. This is particularly true as regards the handling of risks associated with public-private arrangements. Reporting on added value is still inadequate. And, where



supervision is concerned, too little attention is paid to the risks of public-private hybridisation and to the added value produced.

### **Recommendations**

The Netherlands Court of Audit makes the following recommendations:

#### *Minister of Education, Culture and Science*

The Court of Audit recommends the minister to develop a clear legal framework establishing the principles of public entrepreneurship and clarifying the scope available for it and how it should develop. The general principles of public entrepreneurship laid down in this framework (and elsewhere) should allow some scope for diversity in implementation. In this report, the Court of Audit formulates a number of basic requirements for such a framework. It also recommends that:

- supervision by the minister and supervisory body should include a greater focus on public-private arrangements;
- supervisory boards should be given statutory status in order to provide a firmer basis for integrated supervision.<sup>2</sup>

The industry codes should say more about operational management and added value. They have so far paid too little attention to these matters, even though they are essential to secure or identify the benefits of public entrepreneurship. The Court of Audit recommends the minister to urge industry associations to include provisions on operational management and added value in their industry codes.

#### *Organisations with public-private arrangements*

The Court of Audit recommends institutions to publish information explicitly explaining their ideas about public entrepreneurship, i.e. what added value should it produce and how do their public-private arrangements relate to their public-sector tasks? This information will provide a better basis on which internal and external supervisory bodies can decide whether objectives are being achieved and risks properly managed. It would constitute a further major advance in the process of moving from blind trust to proper accountability.

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<sup>2</sup> 'Integrated supervision' means taking all the relevant interests into account and striking a balance between them. See the Meurs Committee report, *Healthcare Governance, Aanbevelingen voor goed bestuur, goed toezicht en adequate verantwoording in de Nederlandse gezondheidszorg*, 1999.



Public entrepreneurship calls for transparent, orderly and auditable operational management that satisfies the requirements of European legislation. It should be clear what private funding is supporting the implementation of public-sector tasks and, vice versa, what public resources are being used to support private-sector activities.

The Court of Audit recommends that institutions should ensure that the reports they publish define the relationship between their public-sector task, mission, long-term objectives (strategy), annual targets and the extent to which public-private arrangements contribute to the achievement of these aims.

Finally, the Court of Audit has devised a checklist that institutions can use to gain a quick impression of their own performance in a number of important areas relating to public-private arrangements.

### **Responses and Court of Audit's afterword**

The draft report was presented not only to the Minister of Education, Culture and Science, but also to the Ministers of Health, Welfare and Sport and Economic Affairs, the chair of the governing board of the ROC MN and the chairs of the management boards of the LUMC and TNO.

Writing with the support of the other two ministers, the education minister endorsed the report's recommendations. She pointed to a number of measures and forthcoming legislative changes which are in line with them.

The response by the governing board of the ROC MN includes a discussion of the measures the organisation is currently taking with regard to cost price calculation, the charging of overheads and the harmonisation of administrative systems in order to identify and control the leakage of public resources. It too endorses the main thrust of the recommendations. In addition, it argues for the introduction of more coherent supervisory arrangements and greater uniformity in the documents formulating the various obligations of the institutions.

The board of the LUMC sees no need to comment on the contents of the report.

The board of TNO notified the Court of Audit of a number of improvements to be made in the operational management field. TNO also



intends to increase the added value of the organisation and the visibility given to it. TNO's annual reports will contain clearer information on its added value to society. Agreement has been reached with the education minister that TNO's supervisory board will make proposals for clarifying its status, tasks and powers.

In its afterword, the Court of Audit acknowledges that the institutions involved in the audit and the ministers responsible for them are taking action in line with the recommendations in a number of areas. It also notes, however, that the large number of guidelines and framework documents may lead to fragmentation and confusion for the institutions.

The Court of Audit points out that the education minister has failed to adopt a clear position concerning the poor performance of the supervisory boards of the educational institutions. It feels that proper provision should be made for institutions in the educational field, as it has now been made for those in health care.

The Court of Audit regrets that the ministers' response confines itself to educational and healthcare institutions, while the report's reasoning, recommendations and checklist apply much wider than simply to the institutions under the aegis of the education ministry that were the focus of the audit. They are also applicable to other institutions involved in public-private arrangements (such as the public broadcasting organisations, arts institutions and universities).

Finally, the Court of Audit notes the vagueness of various standards formulated by the education minister and calls for greater attention to be paid to competition in the establishment of standards for public-private arrangements.



# 1 Introduction

## 1.1 Reasons for performing the audit

From times immemorial, private-sector organisations have performed public tasks, organisations performing public tasks have been funded in part from private sources, public-sector organisations have taken part in public-private partnerships and organisations with a public task have also performed extraneous activities on a commercial basis. Housing corporations, universities and care insurers are examples of such organisations. The organisations involved form a large group and provide important public services.

During the period from January to December 2004, the Netherlands Court of Audit performed an audit of organisations that combine public-sector tasks and public finance with private-sector activities and private finance.

The audit covered three sectors, i.e. adult and vocational education, the university medical centres (UMCs) and the knowledge and innovation sector. Annexe 1 contains more detailed information on the hybrid nature of the sectors selected for the audit.

In order to obtain concrete examples of the way public entrepreneurship works in practice, operational management, and the choices and dilemmas faced in this context, the auditors specifically examined three individual organisations from the sectors selected. The audit focused on the following organisations from the three sectors:

- The Regional Training Centre for the Central Netherlands (ROC MN): contract activities.<sup>3</sup> The ROC MN earns 7% of its revenue (totalling

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<sup>3</sup> Regional Training Centres (known as ROCs) have a statutory duty to provide education. ROCs provide subsidised secondary vocational education in engineering and technology, care and welfare, and business, and prepare their students for a wide range of professions. The ROCs' adult education departments offer courses providing a broad basic education, courses in social and life skills, Dutch for non-Dutch speakers, and adult education. In addition to publicly funded courses, ROCs also provide privately funded contract-based courses and enter into partnerships with private-sector organisations.



€143 million) from contract activities or privately funded activities.<sup>4</sup> The corresponding national figure is 4%.

- Leiden University Medical Centre (LUMC): research studies for external clients (i.e. contract research or research funded by external clients) and the sale of patents and licensing contracts.<sup>5</sup> Funds provided by external clients consist of payments from the private sector, primarily the pharmaceutical industry, and other external clients commissioning medical research.<sup>6</sup> In 2003, the LUMC received approximately €20 million in revenue from external clients (i.e. 5% of its total revenue of €465 million).<sup>7</sup>
- The Netherlands Organisation for Applied Scientific Research (TNO):<sup>8</sup> research projects with mixed public-private funding, privatisation and the sale of patents and licensing contracts. In 2002, 34% of TNO's turnover consisted of public funding, sourced from central government. Dutch and EU government bodies supplied a further 16% of the organisation's turnover. The remainder of its revenue came from private-sector sources. TNO's aggregate revenue was €496 million in 2003. Basic and specific-purpose funding together accounted for approximately 38% of the organisation's revenue in 2003.

The LUMC and the ROC MN were selected because it was clear from their annual reports that they perform contract activities and that they both accept the need for transparency and accountability. TNO was selected because it is by far the biggest player on the knowledge and innovation market. Moreover, TNO adds an additional element to the picture, given that its private-sector activities are not simply supplementary to its public-sector activities; the intermingling of public-sector and private-sector activities may be seen as its characteristic feature and *raison d'être*.

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<sup>4</sup> Regional Training Centre for the Central Netherlands, 2003 Annual Accounts.

<sup>5</sup> University Medical Centres (UMCs) are alliances between university hospitals and medical faculties. The tasks performed by UMCs are patient care, teaching, research and the training of medical specialists. They also perform research studies commissioned and paid for by external clients.

<sup>6</sup> Such as the General Practitioners' Training Foundation and the Healthcare Insurance Board.

<sup>7</sup> LUMC, 2004 Budget.

<sup>8</sup> TNO is an organisation that performs research on behalf of private-sector companies, government bodies and civil society organisations. It acquires and applies knowledge: it undertakes contract research, publishes specialist advisory reports and issues licences on patents and specialist software. It also tests and certifies products and services. TNO also founds new firms to market innovations (see [www.tno.nl](http://www.tno.nl)). The audit took in both the head office and the Nutrition and Food Research Centre.



The case studies are designed to illustrate general issues and dilemmas, and not as a means of assessing the individual organisations involved. For this reason, the conclusions and recommendations are also formulated in general terms, rather than being directed at a specific organisation.

Although the sectors and organisations covered by the audit fall under the responsibility of the Minister of Education, Culture and Science, the problems signalled in the report are of a much wider nature. The recommendations apply to all ministries that deal with mixed public-private organisations. In addition, the Court of Audit hopes that its conclusions and recommendations will help the organisations themselves to improve their efficiency, effectiveness and transparency.

The Minister of Education, Culture and Science responded to the audit in her letter of 15 July 2005. The boards of the organisations concerned responded separately. These responses are summarised in Chapter 9, together with the afterword from the Court of Audit. The full text of the responses is available for inspection on the Court's website ([www.rekenkamer.nl](http://www.rekenkamer.nl)).

## **1.2 Purpose of the report**

The audit is intended to inventory the present position, identify the problems and formulate the issues. The Court of Audit hopes that this report will help to establish a regulatory framework for organisations combining public-sector tasks and public finance with private-sector activities and private finance. The Court also hopes that the report will provide a firmer empirical basis for the current discussion concerning the desirability and feasibility of public-private arrangements, and hence of entrepreneurial behaviour in the public sector.

## **1.3 Audit questions**

The audit revolved around the following questions:

General

- What framework for public-private arrangements is offered by basic legislation and recent industry codes of conduct?



#### Sectoral

- What is the statutory framework for public-private arrangements in the sectors under review?
- Do the reporting and supervisory arrangements generate information on the nature, scale, associated risks and added benefits of private-sector activities and flows of private finance?

#### Organisations

- Why do the organisations under review enter into public-private arrangements?
- What is the administrative and organisational form of the public-private arrangements in the organisations under review? What factors are taken into account in planning these arrangements, and what risks are associated with them?
- Are public-private arrangements demonstrably producing added value and, if so, for whom?

## 1.4 Assumptions

The Court uses certain assumptions in this report in analysing and assessing organisations that combine public-sector tasks and public finance with private-sector activities and private finance.

*The frameworks presented by legislation and industry codes should create opportunities and set objectives.*

Enterprise in the public sector cannot succeed without opportunities and objectives, which are provided by legislation, by standards set by the sectors in question (for example, in the form of industry codes of conduct) and in the form of organisational philosophies and objectives. The Court sought to establish whether existing standards did indeed provide adequate opportunities and objectives for public-private arrangements.

*Operational management should be orderly and auditable, so that risks can be managed and opportunities exploited.*

Various potential benefits are inherent to public-private arrangements, such as a higher standard of public service and greater opportunities for innovation. On the other hand, public-private arrangements also entail certain risks, such as the risk of the leakage of public funds, the risk of certain tasks being neglected and unfair competition. The Court believes that orderly and auditable operational management is absolutely vital in



order to maximise the opportunities and minimise the risks.<sup>9</sup> Sound operational management is also a key condition for the quality and continuity of an organisation's performance. Finally, orderly and auditable operational management provides a firm basis for public accountability. Against this background, it is in the public interest to ensure that operational management procedures are sound.

*Public-private arrangements should generate added value.*

The Court of Audit believes that public-private arrangements should not have an adverse effect on public tasks. Both the government and the organisations in question should make clear what type of added value they expect public-private arrangements to generate. There are different types of added value: financial benefits, benefits in terms of corporate culture, added value in terms of public services (such as a higher standard of service) and added value for society as a whole (such as fostering the development of the knowledge economy). It is not sufficient simply to entertain certain assumptions about added value. The Court believes that clear information should be provided on the added value actually generated by public-private arrangements.

*Annual reports and accounts should clearly state the benefits of public-private arrangements and explain how the associated risks are managed.*

Internal and external reports provide a good means of demonstrating the benefits of public-private arrangements and explaining how the risks can be managed. The Court of Audit sought to establish whether the information contained in annual reports published in the three sectors in question reveals the nature, scale, added benefits, effects (both desirable and otherwise) and associated risks of public-private arrangements.

*Internal and external supervision should focus on the nature, scale, associated risks and added benefits of public-private arrangements.*

The Court of Audit believes that both internal supervisory bodies (such as supervisory boards) and external supervisory bodies (such as inspectorates) should pay attention to the nature, scale, associated risks and added benefits of public-private arrangements. If the mix of public and private activities and revenues does not produce the desired results, appropriate corrective action should be taken by an internal and/or external supervisory body. In relation to the three sectors and

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<sup>9</sup> The Court takes the term 'operational management' to mean the internal control and management of primary and secondary processes aimed at enabling the organisation in question to perform its tasks and achieve its objectives (see Court of Audit, *Achtergrondstudie bedrijfsvoering. Een perspectief op bedrijfsvoering bij de overheid in Nederland en daarbuiten*, 16 May 2001).



organisations under review, the Court of Audit assessed whether the supervisory bodies devoted any attention to public-private arrangements and whether they took corrective action if necessary.

## 1.5 Format of the report

Figure 1 shows the format of the report in diagrammatic form. The various chapters are intended to provide answers to the above audit questions and reflect the various assumptions underlying the Court's analysis.

### Format of the report

#### Figure 1

### Public entrepreneurship

#### Introduction and definitions

*(Chapter 1)*

- The terms 'public' and 'private' in relation to money flows and activities (section 1.6)
- Public and private within organisations (section 1.7)
- The role of public-private arrangements in relation to public entrepreneurship (section 1.8)

#### Standards

*(Chapter 2)*

- General legislation (section 2.3)
- Sectoral legislation (section 2.4)
- Industry codes and advisory reports (section 2.5)

### Public-private arrangements in practice

#### Operational management

*(Chapter 3)*

- Management philosophy on PPAs (section 3.3)
- Separate or merge (section 3.4)
- Cost attribution (section 3.5)
- Ethical standards: outside activities and conflicts of interest (section 3.6)



### **Added value**

*(Chapter 4)*

- Financial benefits (section 4.3)
- Benefits in terms of corporate culture (section 4.4)
- Added value for public tasks (section 4.5)
- Added value for society (section 4.6)

### **Reporting**

*(Chapter 5)*

- Internal reports: information (section 5.3)
- External reports: annual reports (section 5.4)

### **Supervision**

*(Chapter 6)*

- Internal supervision: supervisory boards (section 6.3)
- External supervision: the minister (section 6.4)
- Relationship between internal and external supervision (section 6.5)

### **Conclusions**

*(Chapter 7)*

- Standards (section 7.2)
- Operational management (section 7.3)
- Added value (section 7.4)
- Reports (section 7.5)
- Supervision (section 7.6)

### **Recommendations**

*(Chapter 8)*

- Recommendations made to the Minister of Education, Culture and Science (section 8.1)
- Recommendations made to organisations with public-private arrangements (section 8.2)

## **1.6 The terms 'public' and 'private'**

The terms 'public' and 'private' may be interpreted in a number of different ways and may be used to refer to a variety of dimensions. In all, there are at least seven dimensions in which the terms may be defined.

**Table 1: Dimensions of public and private****Dimensions****'Public'****'Private'****1 Legal status**

Governed by public law

or

Governed by private law

**1 Ownership**

100% government-owned

100% privately owned

**2 Autonomy**

Dependent

Independent

**3 Tasks and activities**

Statutory tasks

Commercial activities

**4 Funding**

100% publicly funded

100% privately funded

**5 Market**

Monopoly

Free competition

Supply-driven

Demand-driven

**6 Value orientation**

Public interest

Commercial interest

Each dimension comes with its own definition of public and private, as is indicated on the 'scales'. This means that public-private arrangements can 'score' differently on each of these dimensions, i.e. on some they are more public, whilst on others they are more private. The present report is geared towards the shaded section of the table, i.e. the 'tasks and activities' dimension and the 'funding' dimension.



## 1.7 Public and private within organisations

### ***Public-private arrangements at different levels***

Public and private aspects may be combined at a number of different levels:

- *in a person*: for example, a professor or medical specialist with outside interests;
- *in an organisation*: for examples, universities or institutions of higher professional education that perform contract research or contract teaching;
- *in a network, in alliances or operational chains of mutually dependent organisations*: for example, public-private partnerships or alliances of care insurers, hospitals and private clinics;
- *in a system*: for example, the healthcare system, which is a jumble of public-private relationships between public-sector and private-sector parties.

This audit centres on organisations combining public-sector tasks and public funding with private funding and commercial activities. In other words, we are interested in public-private arrangements within one and the same organisation, not those involving two or more organisations. The audit also examines two additional issues, i.e. conflicts of interest, and outside activities.

The Court uses the following definition of public-private arrangements made within one and the same organisation:

*A lasting and systematic combination of public tasks and private (i.e. commercial) activities and the associated public and private financial flows.*

The arrangement must be both lasting and systematic. A one-off grant paid to a firm or institution does not qualify. The legal status of the arrangement is irrelevant, as both public-law corporations and companies governed by private law may be involved.

## 1.8 Enterprise in the public sector

Enterprise in the public sector means an organisation enjoying a degree of autonomy in terms of its operational management, plus a professional and innovative deployment of the available resources with a view to achieving constant improvements in the standard of service. In its



advisory report entitled *Ondernemerschap voor de publieke zaak* ('Enterprise in the public interest'), the Social and Economic Council claims that the main benefit of public enterprise lies in its ability to raise the standard of public services and to trigger innovations. Enterprise in the public interest is geared towards an external objective, i.e. ensuring that public-sector tasks are performed as well as possible.<sup>10</sup>

The Social and Economic Council believes that entrepreneurs need a clear framework laid down by the government. In other words, the government should not only clearly define the limits of enterprise, but also set clear goals (i.e. the government should create opportunities and set objectives).

#### ***Social enterprise by institutions of adult and vocational education***

The advisory report published by the Meijerink Committee on educational governance in institutions providing adult and vocational education has the following to say about them:<sup>11</sup>

'Institutions of adult and vocational education have become social enterprises, just like other organisations operating in the education, welfare and housing sectors. They have been given more freedom in which to operate and more responsibility to make maximum use of their freedom. The profits earned by social enterprises remain within the organisation in question and are used to improve the standard of service in the public domain in which they operate. Social enterprises are good at identifying social issues, and are creative, resourceful and professional in finding suitable answers and arranging the necessary funding, from both public and private sources. This is what enterprise is all about.'

The Court of Audit believes that public-private arrangements can help to improve enterprise in the public sector. Public enterprise, i.e. making creative use of the freedom granted to organisations in which to operate, should lead to higher standards of public service and/or to more innovation.

The Court wishes to stress that there are two aspects to the definition of public enterprise. On the one hand, 'public enterprise' means making as much creative use as possible of the available opportunities in order to

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<sup>10</sup> Social and Economic Council, *Ondernemerschap voor de publieke zaak*, The Hague, 2005, p. 25.

<sup>11</sup> Committee on Governance in Institutions of Adult and Vocational Education (Meijerink Committee), *Educational governance bij BVE-instellingen*, 2005.



raise the standard of public services. At the same time, there is also an economic interpretation of the term, based on the principle of 'performing an economic activity' as defined in articles 81-89 of the EC Treaty and in the Dutch Competitive Trading Act.

***A business as defined by the Dutch Competitive Trading Act***

Section 1 (f) of the Dutch Competitive Trading Act defines an 'undertaking' as an entity that performs an economic activity (regardless of its legal status), as opposed to activities of a purely social nature or activities that are intended solely as a means of exercising government authority. The term 'economic activities' is taken as covering any activity that involves supplying goods or services in a particular market. Whether there is an intention to make a profit is not relevant in this respect, nor is it relevant whether the undertaking is owned by a legal person governed by private law or by a corporate body incorporated under public law. The main factor in deciding whether an entity qualifies as an undertaking (where the activity in question is performed by a corporate body incorporated under public law) is the degree of commercial freedom with which the entity operates. In other words, the term 'undertaking' is an economic term that does not necessarily coincide with the two legal terms of 'corporate body' and 'natural person'. If one and the same organisation performs a number of different activities, each activity needs to be assessed before deciding whether it may be classified as an undertaking.<sup>12</sup>

If government bodies decide to start supplying goods and services on the market as part of their public enterprise activities, for example because they feel this helps to raise the standard of the public services they provide, they consequently fall under the legislation on undertakings. 'Private entrepreneurs' and 'public entrepreneurs' may occasionally find themselves at odds with each other. For example, alliances between public-sector and private-sector parties that appear to be highly beneficial to public services may nonetheless come to grief because they are detrimental to another public interest, i.e. the need to create a level playing field and guarantee fair competition.

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<sup>12</sup> House of Representatives of the States General, 2000-2001, 27 870, no. 3. Explanatory memorandum, amendment of the Competitive Trading Act (implementing an amendment to the EU Transparency Directive).

Public entrepreneurship





## 2 Standards

### 2.1 Introduction

This chapter describes the standards applying to public-private arrangements. These standards are set by:

- General legislation

Section 2.3 discusses the current state of the debate on the statutory rules for public bodies operating in the private sector, and also examines European laws that have a bearing on public-private arrangements.

- Sectoral legislation

Section 2.4 describes the current sectoral legislation covering adult and vocational education, the university medical centres (UMCs) and the Netherlands Organisation for Applied Scientific Research (TNO). Statutory tasks and sources of funding are also discussed.

- Industry codes and advisory reports

Finally, there are also standards in the form of industry codes of conduct and advisory reports published in recent years. These codes and reports set governance standards for individual sectors, for example in relation to internal and external supervision, annual reports and operational management. The main points in the various codes and reports are discussed in section 2.5

### 2.2 General impression of standards

An analysis of legislation and industry codes suggests that little has yet been done to codify standards for public-private arrangements. A number of general legislative changes are still in progress (including the introduction of statutory rules for public bodies operating in the private sector and the EU's draft Services Directive). The sectoral legislation provides scope for public-private arrangements, but the intended benefits (i.e. the added value) are not always clear. Whilst industry codes give general guidance on the internal governance and external accountability of 'public enterprises', they pay little attention to the issues of operational management and added value.



In other words, whilst tentative steps have been taken to set standards for public-private arrangements and public enterprise, basically, a clear set of standards is yet to emerge. Similarly, there are no specific objectives that public-private arrangements and public enterprise are expected to meet.

## **2.3 General legislation**

### **2.3.1 Statutory rules for public bodies operating in the private sector**

The government has already spent almost ten years trying to formulate a set of standards for organisations combining public tasks with commercial activities.<sup>13</sup> In a letter to the House of Representatives in 2004, the Ministers of Economic Affairs, Justice and Government Reform stressed the main risks faced by government bodies undertaking economic activities, i.e. unfair competition, risks in relation to continuity and reliability as a result of the inevitable business risks, and the risk of public-sector tasks being displaced by commercial activities.<sup>14</sup>

*A code of conduct* has been drawn up in order to minimise these risks and create a level playing field. The relevant bill is likely to be presented to the House of Representatives at the end of 2005. The provisions of the code cover the pricing of commercial activities and the use of data obtained for the purpose of performing a public task, and also include an obligation to separate public-sector from private-sector activities in organisational terms, so as to avoid any overlaps between the two. Accounting regulations will be published in the near future in support of the code of conduct, so as to enable the Dutch Competition Authority to monitor compliance in an effective manner.

### **2.3.2 European legislation**

Government bodies undertaking commercial activities are subject to the EU legislation on commercial enterprises. European law divides organisations into two categories, i.e. enterprises and governments (officially referred to as 'member states'). The distinction between enterprises and governments is absolutely vital as regards the type of European legislation with which a given organisation is obliged to comply.

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<sup>13</sup> See, for example, the Cohen Committee, Final Report of the Public Sector Market Operations Committee, 20 February 1997.

<sup>14</sup> House of Representatives of the States General, letter to the House of Representatives, 2003-2004, 28 050, no. 7 (review of the Public Sector Market Operations Bill).



It is not possible to classify all organisations that combine public tasks and public funding with private activities and private funding in one of these two categories. The fact that such organisations come in a wide variety of shapes and sizes means that an assessment has to be made on a case-by-case basis. This may lead to the conclusion that an organisation may be classified as an enterprise in respect of certain aspects of its activities, whereas the same organisation operating in a different context may be regarded as constituting a government body. Similarly, it is not always clear from European case law where exactly the borderline lies between a government body and an enterprise.<sup>15</sup>

The main effect of classifying an organisation as a government body is that it then has to comply with EU legislation, for example on public procurement and state aid.<sup>16</sup> If the organisation in question is classified as an enterprise, this means it is subject to the regulations on restrictive practices and unfair competition, including for example the ban on the abuse of a dominant position and price-fixing. State aid may also have the effect of distorting competition, which is why it is forbidden.

#### *EU Transparency Directive*

The European Union has adopted a number of rules on pricing procedures, enshrined in the Competitive Trading Act and the EU Transparency Directive.<sup>17</sup> These regulations are particularly relevant to organisations combining public tasks and public funding with private activities and private funding.

A new chapter was added to the Competitive Trading Act on 15 February 2002, entitled 'financial transparency within certain undertakings'.<sup>18</sup> The provisions of this chapter apply to those enterprises (referred to here as 'undertakings') which have been granted a special or exclusive right or which have been entrusted with providing a service in the public economic interest and which receive state aid of whatever type in relation to this service. If such enterprises also supply other products or services, they are obliged to keep separate accounts for each of their activities,

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<sup>15</sup> Netwerk Toekomst Maatschappelijke Onderneming (NTMO), *De waarde van de maatschappelijke onderneming geborgd*, 2003, p. 46.

<sup>16</sup> The distinction between organisations that are and are not subject to the EU directives on public procurement procedures is not precisely the same as that between government bodies and enterprises; for example, the directives also apply to state-subsidised enterprises.

<sup>17</sup> Commission Directive 80/723 EEC.

<sup>18</sup> Chapter 4A, sections 25a-25f.



and to properly allocate all items of income and expenditure in accordance with objectively justifiable principles of cost accounting.<sup>19</sup>

The requirement that an organisation should keep separate accounts does not apply if the activities in question are already covered by specific EU rules on the separation of accounts. Nor does it apply to enterprises supplying services that do not have an appreciably detrimental effect on trade between member states.<sup>20</sup>

The explanatory memorandum accompanying the amendment to the Competitive Trading Act makes clear that the term 'separate accounts' is intended to mean it should be clear which particular items of income and expenditure relate to each of the various activities and how these items are allocated.<sup>21</sup> Whilst every enterprise is free to choose its own particular method of cost allocation, it should be clear which accounting principles are being used (e.g. which method of cost attribution it has chosen to use) and costs should be allocated on a proportional basis, i.e. in accordance with the use made of the assets in question.

#### *State aid*

The ban on state aid affects organisations combining public tasks and public funding with private activities and private funding in two different ways. Firstly, governments may provide assistance only subject to certain conditions. The fact that one and the same organisation may be classified as both a government body and an enterprise makes this especially relevant. The European Commission's current policy on public services may be summarised as follows: governments are entitled to grant aid to enterprises or organisations if this is in consideration of the provision of services normally supplied by the government. Under the most recent case law, this type of payment does not need to be reported to the Commission provided that certain strict conditions are met. Among the circumstances in which member states are obliged to report instances of state aid to the Commission are if the amount involved is greater than €100,000 per enterprise over a three-year period, and if the aid is not freely available. The aid may not be granted until permission has been given.

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<sup>19</sup> Section 25b (1), Competitive Trading Act.

<sup>20</sup> Section 25c, Competitive Trading Act.

<sup>21</sup> House of Representatives of the States General, 2000-2001, 27 870, no. 3 (amendment of the Competitive Trading Act, implementing an amendment to the EU Transparency Directive).



Generally speaking, government funding of research and development activities by public establishments of higher education or research does not qualify as state aid as defined by article 92 (1) of the EC Treaty.<sup>22</sup> In order to obtain approval, organisations are generally required to prove that the project they wish to perform will have an incentive effect, i.e. that it will make a substantial contribution to the general development of certain types of economic activity.<sup>23</sup>

#### *Services Directive*

As more and more foreign players move into the Dutch market and more and more Dutch suppliers move into the European market, so the Services Directive (dubbed the 'Bolkestein Directive' after ex-internal market commissioner Frits Bolkestein) is becoming increasingly relevant. The Services Directive is still under discussion and has not been ratified yet.<sup>24</sup> In the meantime, the education, research and knowledge and innovation sectors are becoming steadily more international, which means that the Services Directive will also have a bearing on the sectors covered by this report.

The Services Directive aims to create a free market in services, and is based on the 'country of origin principle', which means that a service provider is governed exclusively by the laws of its country of origin and that EU member states are not permitted to place any restrictions on services provided by a service provider based in another member state.<sup>25</sup> The Services Directive is likely to have a huge impact on markets that have been dominated by domestic suppliers to date. It could result a number of suppliers operating on the same market, each of which is covered by a different supervisory and reporting regime and different terms of employment. The debate on the details of the Services Directive was still ongoing when this report was finalised.<sup>26</sup>

## **2.4 Sectoral legislation**

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<sup>22</sup> See: Information from the Commission – Community framework for state aid for research and development (96/C 45/06).

<sup>23</sup> Source: [www.europadecentraal.nl](http://www.europadecentraal.nl) (state aid – regulations on dispensation).

<sup>24</sup> European Union, Proposal for a European Parliament and Council Directive on services in the internal market, 25 February 2004.

<sup>25</sup> European Union, Proposal for a European Parliament and Council Directive on services in the internal market, 25 February 2004.

<sup>26</sup> See [www.Europadecentraal.nl](http://www.Europadecentraal.nl) for information on the current state of affairs with regard to competition legislation, the framework for state aid, and the Services Directive. See also Court of Audit, *EU Trend Report 2004*, House of Representatives, 2004-2005, 29 995, nos. 1-2.



### *Adult and vocational education*

Under the Adult and Vocational Education Act, Regional Training Centres (ROCs) offering adult and vocational courses are permitted to undertake contract activities, provided that certain conditions are met. In an explanatory memorandum accompanying the funding regulations (known as the 'Clarity Memorandum'), the Ministry of Education, Culture and Science explains that it expects this type of activity to help raise the standard of teaching.

#### **Clarity in the funding regulations**

The Ministry of Education, Culture and Science published two memoranda in 2003, one for institutions providing adult and vocational education and the other for institutions of higher education, in which it sought to clarify the funding regulations.<sup>27</sup>

The memorandum on the funding of institutions providing adult and vocational courses states, *inter alia*, that public funds may not be invested in private-sector activities for financial reasons only. Such investments must both help to raise the standard of teaching and be in the interests of the parties involved. The Ministry of Education, Culture and Science claims that the two memoranda are not regulations in themselves, but rather seek to explain the provisions of the Adult and Vocational Education Act. In other words, so the Ministry says, they are of an explanatory nature. The memorandum on the funding of institutions providing adult and vocational education has been incorporated in the financial statements which the ROCs are required to submit every year. The two memoranda are 'living' documents that are regularly updated to reflect the latest thinking.

Another important document – in terms of permitting a mixture of private-sector and public-sector activities – is *Koers BVE* ('The future of adult and vocational education'). The 2004 edition of this document describes the promotion of enterprise as a key objective: 'Vocational education institutions can play the vital role expected of them, i.e. display more innovative ability and greater competitiveness, only by adopting a more entrepreneurial attitude.'<sup>28</sup> *Koers BVE* underlines the importance of

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<sup>27</sup> See Ministry of Education, Culture and Science, *Helderheid in de bekostiging van het beroepsonderwijs en de volwasseneducatie*, 2003, and *Helderheid in de bekostiging van het hoger onderwijs*, 2003.

<sup>28</sup> *Koers BVE: Het regionale netwerk aan zet*, June 2004, p. 32.



the institutions' regional role,<sup>29</sup> and more specifically of their influence on publicly funded education.<sup>30</sup>

#### *UMCs*

Like the ROCs, the University Medical Centres (UMCs) are entitled to perform contract research on behalf of external clients. The Ministry of Education, Culture and Science has also clarified its position with regard to higher education: contract activities must help to raise standards and assist in the process of knowledge transfer, and may not distort competition. The Ministry of Education, Culture and Science believes that public-private partnerships are necessary in order to promote the development of the knowledge economy, and takes the view that individual institutions are responsible for making their own choices in this respect. The UMCs are not obliged to report on the nature and scale of their contract research.

#### *TNO*

Cooperation with the private sector is core business at TNO. The government exerts external control over TNO by means of a four-year strategic plan and the annual allocation of funding. The organisation's medium-term and long-term goals are set out in its strategic plan, which also describes its main policy aims. Every year, the Minister of Education, Culture and Science receives a grant application from TNO's management board (which the latter first submits to the supervisory board for approval), which it decides on on behalf of the government after consulting the Ministers of Economic Affairs, Defence and Health, Welfare & Sport.

The multi-annual 'specific-purpose funding' programmes are approved by the relevant ministries. Under the system of specific-purpose funding, the ministries in question specify the type of research for which the funding is intended. The multi-annual programmes describe the specific applications for which the research is intended to cater. The specific-purpose funding provided by the Ministry of Economic Affairs can be used for knowledge-

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<sup>29</sup> Koers BVE: Het regionale netwerk aan zet, June 2004, pp. 33-34.

<sup>30</sup> The Social and Economic Council (SER) takes the view that the document entitled *Koers BVE* is not sufficiently explicit about the government's managerial role. The SER believes, first of all, that the government should be more energetic and decisive in setting the pace. Secondly, and in conjunction with the first point, the government is overly cautious about its own role in the policymaking process. (Source: SER Advisory Report no. 04/13: *Opleiden is net-werken: Advies over de koers van het middelbaar beroepsonderwijs en de volwasseneneducatie*, 17 December 2004, p. 3.)



development projects that are cofinanced by Dutch private firms. For this reason, this arrangement is known as the 'cofinancing scheme'.

## 2.5 Industry codes and advisory reports

Alongside the standards set in the form of general and sectoral legislation, standards are also set in the form of industry codes of conduct and various advisory reports that have been published in recent years. The latter contain governance standards for each sector, for example in relation to internal and external supervision, annual reports and operational management.

### ***The Court of Audit analysed the following codes of conduct and advisory reports***

- Healthcare Governance Committee (Meurs Committee), Healthcare Governance, Recommendations for good governance, effective supervision and proper reporting in the Dutch healthcare sector, 1999
- Glasz Committee, Health Insurance Governance, 2002
- Network for the Future of Social Entrepreneurship (NTMO), De waarde van de maatschappelijke onderneming geborgd ('Securing the value of social enterprises'), including code of conduct for social enterprises, 2003
- Corporate governance code for executive agencies drawn up by the autonomous administrative authorities which signed up to the Charter of Public Accountability, 2004
- NVZ Association of Hospitals, NVZ Corporate Governance Code, Principles with recommendations, Utrecht, 2004
- Final report of De Boer Project Group, Public governance and corporate social responsibility, 2004
- Education Council, Good governance in education (advisory report), 2004
- Meijerink Committee on educational governance in institutions of adult and vocational education, 2005

Despite the rapid pace of change, a common, pan-sectoral frame of reference would appear to be emerging from industry codes and advisory reports in relation to the topic of governance. For example, all the codes express a desire for clarity about the nature of relations between the various management organs. Separating management from supervision is a key aspect of this, as is the formulation of a set of criteria to be met by



the statements from management and supervisory boards included in an organisation's annual report. There would appear to be a broad consensus on a number of basic requirements, such as the need to avoid unfair competition and conflicts of interest, to provide clear information on business risks and to clarify the role and duties of supervisory boards, the external auditors and the audit committee.

Although the codes suggest there is broad support for a number of principles, they do not devote much time to explaining how they should be applied, i.e. how should integrated supervision be exercised, and how should items of revenue and expenditure be properly allocated? Again, whilst the codes are agreed on the need for stakeholder involvement, there is less clarity about who the stakeholders are, who is responsible for defining them and how stakeholder involvement is to be reconciled with political primacy.

Most codes of conduct pay very little attention to the specific requirements that public-private arrangements and public enterprise attach to internal and external governance. For example, the codes have very little to say about operational management and reporting on added value. At the same time, the most recent (finalised and draft) codes, i.e. the code of conduct published by the Meijerink Committee on educational governance in institutions of adult and vocational education and the NVZ corporate governance code for hospitals, do include sections on operational management.

The same applies to the relationship between the internal supervision exercised by a supervisory board and the external supervision exercised by a minister: this is not a subject that is addressed in any detail by the various codes.<sup>31</sup> Nor is the issue of compliance: most committees have expressed a preference for self-regulation, such as by making observation of the code a condition of membership of an industry association. The 'comply or explain' philosophy is also cited on a number of occasions.

But can anyone ensure that these reports and codes of conduct do not founder in a sea of good intentions? A number of codes contain observations on the issue of enforcement and recommend ways and means of ensuring that their provisions become an accepted feature of corporate life.

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<sup>31</sup> The proposals made by the Meijerink Committee form an exception in this respect.



- The *De Boer Project Group*, for example, claims there is scope for improving the way in which 'the supervisory authorities are themselves supervised', and reports that there are already ideas as to how this should be done, some of which have been translated into industry codes of conduct. The project group concludes that the government has not yet adopted a clear policy on this point.
- The *Meijerink Committee* states that 'the government is not in a position to intervene directly, ... apart from in exceptional circumstances through the courts'. The Committee feels that this is an omission, and recommends that an external, independent body be set up that is capable of intervening if needed.
- The *Education Council* writes in its report that a governance code 'could form part of a covenant between the minister and the industry association'.

Public entrepreneurship





## 3 Operational management

### 3.1 Introduction

Apart from creating new opportunities for public services, the combination of public tasks and public funding with private activities and private funding also entails a certain level of risk, such as the leakage of public funds and the risk of adverse effects on an organisation's public task.

The Court of Audit examined how the selected sectors and organisations organise their operational management so as to manage the growth of their commercial activities, maximise opportunities and minimise risks. This chapter sets out the Court's findings on the operational management aspects of public-private arrangements.

The Court examined four specific aspects of operational management:

- the management board's ideas about public-private arrangements and the strategy it has mapped out for the organisation in question (section 3.3). The management board's views are important because of the need to define the limits of free enterprise. The management's philosophy should make clear how the organisation seeks to strike a balance between its public task and its private activities. This should help to reduce the risk of public interests playing second string to commercial success;
- the way in which the organisations under review resolve the problem of how to separate public from private funding and public tasks from private activities (or how to amalgamate them) (section 3.4);
- the cost accounting and pricing methods used in connection with public-private arrangements (section 3.5). It is possible to eliminate the risk of the leakage of public resources (i.e. the cross-subsidisation of private-sector activities by public funds) by keeping accurate accounts of public and private funds, including items of both revenue and expenditure. Distortion of competition and cross-subsidisation can be prevented by correctly attributing costs to either public-sector or private-sector activities, and by passing on all charges to customers;



- the way in which ethical risks are managed. The main issue addressed by the Court was whether the organisations under review had adopted regulations or codes of conduct relating to outside activities and conflicts of interest (section 3.6).

If public tasks are combined with private activities within one and the same organisation, this may result in conflicts of interest affecting members of staff. Codes of conduct or regulations dealing with ethical standards of behaviour, outside activities (whether commercial or otherwise) and outside sources of income (whether commercial or otherwise) can reduce the risk of public tasks being neglected.

### **3.2 General impression of operational management**

The audit of the three individual organisations produced a varied picture. In all three, there is in theory – and largely in practice – an administrative separation between public and private-sector funds in the parts of the organisations audited.

In all three, however, the way in which cost prices are calculated is deficient in certain respects. This entails a risk of private-sector activities being cross-subsidised by public funds, and hence of irregularities and of the misuse and improper use of government grants (for example, if certain funds are not spent on public-sector tasks). There is also a risk of distortion of competition. In the case of the LUMC and ROC MN, the amount of money potentially involved is small, given the relatively modest extent of their contract activities.

The ROC's contract activities are not yet firmly embedded within the institution. As a result, the risk of a leakage of public funds and adverse effects on the institution's public task cannot be ruled out. However, the ROC is currently undertaking a complete reorganisation of its contract activities.

The LUMC is taking a number of measures to deal with the risks associated with contract activities. Although its cost attribution and pricing procedures are transparent, there is a lack of consistency in the charging of staff costs. Also, licence management needs to be improved.

In the case of TNO, the aspects of operational management examined in the audit are generally in order. However, there is room for improvement as regards knowledge management and the cofinancing of projects, for



example in the procedures for setting the 'market price' and in licence management.

### **3.3 Management philosophy and long-term strategy**

In theory, both ROCs and UMCs are free to decide whether or not to undertake contract activities, although competition from fellow institutions in both sectors compels them to adopt an entrepreneurial attitude. The ROC MN wants its contract activities to be profit-making on a long-term basis (an objective it has not yet succeeded in attaining).

The LUMC is averse to risk in relation to its contract activities, which it undertakes only if they are consistent with its research programme. Private funding is a vital supplement to its government income.

At TNO, mixing private funding and activities with public funding and tasks is part of its core business.

The ROC MN showed that it can contain the risk of an adverse impact on public tasks by recruiting extra staff on temporary contracts. The Court wishes to point out, however, that the recruitment of temporary staff restricts the opportunities for cross-fertilisation between public and private activities, which the ROC MN is indeed hoping to achieve. UMCs are subject to regulations regarding the amount of time spent by staff on teaching duties and patient care. Both the ROC MN and the LUMC point to what they describe as 'reverse cross-subsidisation', i.e. the fact that contract activities generate revenue that is capable of benefiting public services. In other words, the performance of contract activities can be in the public interest. This is an aspect discussed in the following chapter, under the heading of 'added value'.

### **3.4 Separate or merge**

#### **3.4.1 Organisational structure**

The ROC's contract activities are not yet firmly embedded in its organisational structure. The ROC MN is hoping to both autonomise and corporatise and to separate its activities into public and private divisions. The idea would be for its private division to be responsible for its contract activities, which would be performed by independent limited companies.

At the LUMC, contract research is fully blended into the Centre's organisational structure and is not handled by a separate organisation, as



is the case at a number of other UMCs. This is deliberate policy, the aim being to create synergy between research, teaching and patient care.

At TNO, there is no separate organisational entity that is responsible for research projects funded from both private and public sources. This is again a matter of policy, the aim being to encourage synergy, as is also the intention of the Ministry of Economic Affairs. The situation is different in the case of the privatisation of subsidiary companies, which are set up under a separate holding company and given a period of three years in which to prove their commercial viability. Any high-risk investments (including minority interests) also take the form of separate legal entities.

### **3.4.2 Administrative structure and accounting procedures**

#### *ROC MN*

At the time of the audit, the ROC MN was still working on its administrative structure in general, and on the accounting procedures for its contract activities in particular. The Court noted that separate accounts were kept for public and private financial flows.

#### *LUMC*

Separate accounts are kept for all financial flows at the LUMC. There is an accounting manual that applies to all research projects. The 2003 management letter from the external auditors referred to various risks associated with the project accounts.

Separate accounts are kept of all items of revenue and expenditure in relation to individual projects. All projects can be categorised on the basis of their source of funding. The Court found a number of shortcomings in the hard-copy versions of the project files.<sup>32</sup>

The LUMC's internal regulations contain a provision to the effect that departmental funds are to be used for the sole purpose of performing public tasks, with one exception: making good any losses incurred on contract research activities.<sup>33</sup> The LUMC does not keep a record showing

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<sup>32</sup> The LUMC said that it hoped to have remedied these shortcomings by 1 January 2005.

<sup>33</sup> Until 1999, professors and medical specialists were not fully employed by the UMC in question, but earned an income from private practice (undertaken as a partnership or a sole trader, for example) in addition to their salaries. This outside income was paid into special funds for individual professors and medical specialists; these were known as Personal Academic Loans (PWKs). Any losses incurred on contract research were charged to the PWKs, and any profits transferred to them. The PWKs were added to the hospital's assets in 1999, when the professors and medical



how much of departmental funds consists of public funds and how much of private funds, nor of whether this money is spent on public-sector or private-sector activities. As a result, no full information is available on the risk of cross-subsidisation or on the added value that private funds are potentially capable of creating for public resources.

The LUMC is currently compiling a list of all non-profit-making foundations and other corporate bodies that are associated with it through personal links of various members of staff. This stock-taking operation is likely to reveal the existence of foundations whose assets should, in the normal run of things, be regarded as being the property of a departmental fund. The assets in question will be transferred to the departmental funds later on in the year, thus guaranteeing, in theory, that they will be spent on public-sector activities.

The LUMC adopted a knowledge-transfer policy two years ago, which is aimed at protecting its intellectual property. There are still a number of shortcomings in the way in which the LUMC manages its patents and licences, however. For example, the LUMC does not have a register of patents. Also, a number of licensing contracts were missing from one of the patent files examined by the auditors. The LUMC is currently setting up a department that will be responsible for protecting and transferring its intellectual property.

#### *TNO*

TNO has adopted fairly extensive guidelines for accounting for and monitoring projects funded from both private and public sources. In their 2003 management letter, the external auditors recommended improving a number of procedures for knowledge investment projects. The Court of Audit made a point of examining the accounting procedures in relation to projects funded from both private and public sources, and found that separate accounts were indeed kept for the public and private financial flows relating to individual projects.

Over five years ago, TNO adopted a special policy on and set up a separate entity for the management of its patents.<sup>34</sup> The flow of revenue

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specialists became fully-fledged hospital employees. In 2004, the PWKs were subsumed into the departmental funds.

<sup>34</sup> The term 'patent management' is taken to mean the entire process, from the assessment of inventions up to and including the application and maintenance of patents. The term 'licence management' relates to situations in which a third party is authorised to make use of a patent.



from patents is not always closely monitored, however. Moreover, the process by which potential patents are assessed, up to and including the management of licensing contracts, is not well documented and hence not open to full scrutiny. There is also scope for improving the documentation on and assessability of the privatisation process.

### **3.5 Cost attribution and pricing**

#### *ROC MN*

Despite the existence of a cost accounting model, the ROC MN has not yet adopted a standard method of cost accounting throughout its organisation. This is partly due to the after-effects of the merger. The cost accounting model currently used generates fees that are based on direct wage costs, plus estimates for the cost of equipment and overhead expenses (although no account is taken of the costs relating to the management board). No information is available on the actual cost of staff and equipment.

The Court concluded that the system of cost accounting does not allow the ROC MN to charge its clients for the costs actually incurred. There is also scope for improving the way in which the profit mark-up is calculated.

#### *LUMC*

Budgets for contract research projects at the LUMC consist of three items: staff expenses, a mark-up for overhead and infrastructure expenses, and the cost of equipment. The sum total of these three items is the price charged to the client, mainly in the form of a contract price. All contract research projects are supposed either to break even or to generate a small profit. It is not clear whether the mark-up, i.e. 16.5% of staff expenses, covers all indirect costs. In a number of projects, the Court found that the actual level of cost was much lower than the amount for which the LUMC had budgeted, because the costs of professors and medical specialists were not actually charged to the projects, despite appearing in the relevant budgets. The profits or losses made on contract research projects are either credited or charged to the department responsible. The LUMC's management board pointed out that there are sometimes good reasons for performing a research project funded from the private sector for less than the cost price. Certain academic benefits, such as greater knowledge, a higher status, publication scores, citation scores, etc. may be derived from performing such projects 'at any cost'.

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The management board believes that this does not pose a risk of cross-subsidisation, as the projects in question would have been undertaken anyway at some stage, with or without the presence of private funding.<sup>35</sup> Moreover, the management board made clear that the LUMC had a policy of keeping research findings in the public domain.

#### *TNO*

TNO uses a system of comprehensive cost attribution. This involves calculating an all-inclusive cost price on the basis of the direct staff expenses, plus a mark-up for indirect costs, i.e. overhead expenses. TNO does not work with 'standard' indirect expenses. In certain cases, TNO also works for less than the cost price. The idea is that projects should make a 3% 'profit', so as to cover any losses incurred. This level of profit is not consistently attained in practice, however. The profits or losses are either credited or charged to the institution responsible for the research project in question.

### **3.6 Ethical standards: outside activities and conflicts of interest**

Although the ROC MN does not have a code of ethical conduct in relation to conflicts of interest and outside activities, it has given its backing to the relevant provisions of the industry code for institutions of adult and vocational education.

There are a number of codes of ethical conduct in operation at the LUMC, two of which are geared specifically towards the risks inherent to public-private arrangements. There is no central department that monitors compliance with these codes. The LUMC also has a set of regulations for outside activities; this is a stricter version of the relevant provisions of the collective agreement for staff employed by university hospitals. The LUMC is currently compiling a full list of outside jobs performed by all members of its staff.

Although TNO has adopted a code of ethical conduct, this concentrates on professional ethics and does not refer specifically to outside activities and

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<sup>35</sup> An organisation that systematically charges loss-making fees may find itself the subject of a fine imposed by the Dutch Competition Authority. For example, the 2003 Annual Report published by the Dutch Competition Authority mentioned that an educational establishment had received a provisional fine. The Dutch Competition Authority assumed that the establishment in question was abusing its dominant position by systematically selling at a loss the same courses that were also sold by one of its competitors. Source: 2003 Annual Report of Dutch Competition Authority, p. 25.



conflicts of interest. Although staff are obliged to report any outside activities, neither the head office nor the individual institutions maintain a register or use a monitoring system. There are no clear criteria for assessing outside activities.



## 4 Added value

### 4.1 Introduction

One of the reasons for performing commercial activities alongside public tasks, and looking for private sources of funding, is the desire to add value. There are various types of added value in the sectors under review:

- financial benefits for the organisation in question (section 4.3);
- benefits for the organisation itself, in terms of culture change and staff attitudes (section 4.4);
- added value for public tasks, in terms of the standard of service or of the 'subsidisation' of public resources by private resources (section 4.5);
- added value for society, for example by stimulating the development of the knowledge economy, improving the ability of the Dutch to innovate, and ensuring that students are better prepared for the job market (section 4.6).

### 4.2 General impression of added value

The Court of Audit concludes that, although the public-private arrangements do produce added value in a number of respects, the results do not always come up to expectations. Except as regards their financial benefits, institutions provide little or no information, for example in their annual reports, on the added value of their private-sector activities and private funding. There is nothing to prevent them from reporting on these matters, though, since (as we have already said) there are plenty of cases in which it is possible to demonstrate that added value has indeed been created.

### 4.3 Financial benefits

The ROC MN makes a loss on its contract teaching. The LUMC makes a profit on research projects that are funded either wholly or partly from private sources. TNO generally makes a profit from the privatisation of its institutions.



TNO and the LUMC also earn revenue from patents and licences. There is scope for improving the way in which patents and licences are managed by both TNO and the LUMC, and in the information provided on earnings from patents and licences. The same applies to the sale of 'knowledge'.

Whether a loss or a profit is made depends partly on the type of costs that are taken into account when calculating the cost price. We reported in section 3.5 that, although the organisations under review use models for cost accounting, they do not always take account of all relevant costs (including those relating to head-office overheads and the use of a shared infrastructure). In a number of cases, there is also scant information on the actual level of cost and in certain cases the price quoted is less than the cost price (although there may be good reasons for doing so).

All three organisations report on the profits or losses made by individual business units or companies (see also Chapter 5 in this connection).

#### **4.4 Added value for corporate culture**

##### *General*

All three organisations under review cite 'changes in corporate culture' as being one of the forms of added value offered by public-private arrangements. This type of added value falls into two categories:

- a change in staff attitudes: the inculcation of a spirit of enterprise;
- a change in corporate culture: the adoption of a more commercial culture.

The organisations also suggested that a more entrepreneurial spirit might also benefit an organisation's image (by suggesting it is more 'customer-oriented') and raise its prestige ('more research') among stakeholders.

It is hard to define – and indeed to measure – added value where this takes the form of a change in staff attitudes or corporate culture. The general impression is that, although the staff of the organisations under review set considerable store by their public mission and their terms of employment, they have no objection to adopting an entrepreneurial approach to their work – in the sense of being innovative and creative. The management would appear to be more interested at present than the staff in signing up to flexible terms of employment that reflect current practices in the marketplace.



The Court would like to comment, however, that bringing about a change in attitudes and corporate culture sometimes seems to be an end in itself. It is important to bear in mind that such a change should be seen more as a means or as a condition for successful public enterprise.

#### *ROC MN*

The impression gained from the interviews conducted by the Court of Audit is that, whilst there are instances of cross-fertilisation at the ROC MN, the management feels that they are far too few in number. This could be a reflection of the organisation's internal culture, which is not open to sudden change. Teachers are very keen to protect certain provisions in their collective agreement, such as those on holidays and the distribution of workloads, which the management feels prevents them from deploying their teaching staff in a flexible manner. Moreover, many teachers are used to taking a supply-driven approach to their work, whereas contract activities require a demand-driven approach.

The merger between the Utrecht Regional Training Centre and the Amerlanden Regional Training Centre brought together two different approaches to contract activities. The Utrecht Regional Training Centre was used to operating more cautiously on the market than the Amerlanden Regional Training Centre, where there was more scope for innovation, experimentation and bold entrepreneurial initiatives than at the former institution. In a number of instances, this resulted in big contracts being signed with various national companies.

#### *LUMC*

On the one hand, the LUMC encourages its researchers to show initiative. It assists members of staff who wish to start their own businesses after coming up with promising inventions. This it does by giving them advice, by helping them set up their own business (with the aid of the Incubator scheme,<sup>36</sup> for example) and by assisting in the transfer of intellectual property. On the other hand, there have been only three instances in the past five years of a researcher asking the management board for permission – and the management board granting such permission – to market an invention outside the LUMC. Moreover, in all three cases, the staff concerned ended up remaining in the employment of the LUMC.

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<sup>36</sup> Incubator is the name given to a subsidy scheme operated by the Ministry of Economic Affairs, which is intended to help young companies with aspects such as accommodation and infrastructure.



The LUMC has a policy of not getting involved in commercial initiatives. Both the management board and the supervisory board say that they do not wish to run any business risks and do not wish to supply either management capacity or financial resources for commercial undertakings.

#### *TNO*

The corporate culture aspect at TNO is reflected *inter alia* by the privatisation process that is taking place under the flag of TMB (TNO Management BV). The picture that emerged from interviews is that the corporate culture at TNO is not immediately compatible with privatisation. Many of the staff at TNO, for example, value the terms under which they are employed. They feel closely involved with the fortunes of the TNO organisation, and most of them have no particular desire to leave the organisation. In addition, the question of customer orientation is an issue that crops up in training courses, performance appraisal interviews, project evaluations and customer satisfaction surveys. Finally, one of the interviewees commented that it was sometimes better to have both an entrepreneur and a researcher operating in the same team, rather than expecting one and the same person to combine both business and research skills.

## **4.5 Added value for public tasks**

The ROC MN and the LUMC in particular made clear that public-private arrangements can improve the performance of their statutory tasks. The ROC MN claimed that contract activities were beneficial to the quality of teaching and of the teaching staff.

The LUMC also claimed that contract research should ultimately improve the standard of patient care services. It pointed out that research funded by external clients creates new openings in its research programme and hence helps to improve the standard of its public services.

TNO differs from the two other organisations in relation to this particular aspect of added value. The point is that TNO's added value lies precisely in its ability to develop knowledge by working in unison with private firms. Whereas organisations in the two other sectors are free to decide whether or not to undertake commercial activities, TNO is under a statutory obligation to enter into partnerships with private-sector firms.

The Court found that, whilst the ROC MN is clearly aware of the wealth of opportunities presented by public-private arrangements, it tends to



describe these in general terms. At the same time, the ROC MN was able to quote a number of examples in which contract activities have had a beneficial effect on public services. For example, the ROC MN writes in its 2003 annual report that its contract activities 'enable it to invest in better facilities, from which its publicly funded courses can in turn benefit'. Questioning revealed that the facilities involved were e-learning courses, a skills lab for students in training as security officers, an open learning centre and the revamping of a number of technical courses.

The LUMC claimed that both teaching and research (both of which are public tasks) benefit from the knowledge gained from privately funded research. In addition, it assumed that the knowledge it acquired partly with the aid of private resources was disseminated in the form of better methods of treatment, effective drugs and better equipment. In other words, patient care services also benefited from contract research.

If a private company (or another external client) is prepared to spend money on research that one of the LUMC's departments was intending to perform in the first place, this has the effect of freeing up government resources for spending on other research projects. Given that all research proposals need to be approved by the management board, the latter believes this guarantees that all research projects must form part of approved research programmes and that the research agenda is not set by manufacturing industry.

The Court found that both the ROC MN and the LUMC could put forward arguments and examples in support of the view that contract activities benefit public services. Nonetheless, the Court does wish to point out that both the internal and external reports published by the two organisations have very little to say about the actual impact that public-private arrangements (such as contract research and teaching) have on the standard of their public services. Whilst there are plenty of examples, there is no systematic information or reporting mechanism.

#### **4.6 Added value for society**

Both the government and the organisations under review cite 'added value for society' as one of the main objectives of private-sector activities. This includes, for example, the use of knowledge for social applications (in the case of the UMCs and TNO) and the ability to offer courses that prepare students for the demands of the job market (as in the case of the ROCs).



The audit showed that the organisations under review had adopted procedures and rules to secure the added value of research findings for society. It is clear, *inter alia*, from TNO's and the LUMC's mission and from the procedures for the protection and transfer of intellectual property that this is an object pursued by both organisations.

***Securing added value for society: an example***

The LUMC has drawn up patent and licensing rules so that as many patients as possible benefit from the findings of medical research.<sup>37</sup> For the same reason, the UMCs and TNO have incorporated an 'anti-shelving' clause in their licensing contracts.<sup>38</sup> Another indication that the LUMC wishes to develop and disseminate expertise is the fact that it prefers to grant exclusive licences rather than a series of licences based on a single patent.<sup>39</sup>

Although the organisations' external reports contain hardly any information on the added value for society, the audit did reveal the existence of plans for reporting on the societal added value. In 2002, for example, the Royal Netherlands Academy of Arts and Sciences published a report on the societal impact of applied medical research.<sup>40</sup> One of the recommendations made in this report was that, in addition to monitoring the scientific quality of applied scientific research, efforts should also be made to either measure or prove its societal impact. The report mentioned by way of an example the period of time which has to elapse before research findings may be widely used.

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<sup>37</sup> The reason for filing for a first-stage patent on an invention is the fact that this allows the UMC to retain the knowledge for a number of years, thus allowing the expertise in question to be further refined. This gives time to the public domain and prevents commercial parties from 'fencing in' the expertise and allowing patients to benefit from it only at high cost.

<sup>38</sup> The clause (which literally states that [...] 'may not remain on the shelf') is intended to prevent the expertise in question from being protected when no use is actually made of it. The protection afforded by the licence lapses if the IPR holder does not exercise its rights for a period longer than a specified number of years.

<sup>39</sup> The rationale behind this is that this will encourage licensees to obtain a licence and refine the expertise in question, rather than creating a situation in which the licensee is obliged to share its rights with a number of other parties (i.e. competitors). In other words, where an exclusive licence is granted, there is more chance of the invention in question being refined and of its benefiting patient care than in a situation in which more than one licence has been granted.

<sup>40</sup> Royal Netherlands Academy of Arts and Sciences: The societal impact of applied health research, Amsterdam, 2002.



Since 1996, TNO has used indicators in the reports it compiles for the Minister of Education, Culture and Science. These were recently extended with a number of 'societal impact indicators', which were also included in the 'knowledge status audits' performed for a number of TNO institutes to gain an indication of their social relevance. TNO pointed to the positive findings generated by this type of audit, and also to the fact that these audits formed part of a 'system of reporting to the government and society'.



## 5 Annual reports and accounts

### 5.1 Introduction

After discussing the issues of operational management and added value, we now wish to examine reporting mechanisms, as being the third aspect of public enterprise in general, and public-private arrangements in particular.

This chapter works on the assumption that there are two types of reports: internal reports (section 5.3) and external reports (section 5.4).

### 5.2 General impression of annual reports and accounts

The analysis of the annual reports shows that, although the organisations do provide some information and figures on their public-private arrangements in their published annual reports and annual financial statements, the amount of information and the level of detail vary.

The information published in the annual reports of the institutions involved in the audit is not sufficient to justify any conclusion as to whether their public-private arrangements contribute to a beneficial cross-fertilisation between their public and private activities. Their annual financial statements and annual reports proved to contain very little explicit information about the potential added value and risks of public-private arrangements.

The general impression is that internal reports provide more detailed information about the nature, extent and financial results of public-private arrangements than external reports, but that even internal reporting systems are not designed to provide information on the added value and risks of public-private arrangements (or on ways of dealing with these risks).



### **5.3 Internal reports: information**

There is plenty of internal information available on contract teaching (at the ROC MN), contract research (at the LUMC), mixed public-private projects (at TNO) and privatisation projects (again, at TNO). The bulk of the data provided concerns the nature and scale of the arrangements, and their financial results.

The internal reporting cycle does not include information on the degree to which public-private arrangements help the organisation in question perform its statutory tasks or achieve its mission or long-term objectives.

The internal reports published by the ROC MN do not say a great deal about why certain contract activities are performed and how they raise (or are intended to raise) the standard of the public services performed by the Centre. At the same time, the ROC MN has launched a review that is designed to reassess the usefulness of the large number of contract activities it performs.

Both the LUMC and TNO perform an assessment, before starting a given contract activity, of whether private-sector activities, private funding and alliances with private-sector parties are consistent with their long-term research policies. There are also other ways, such as evaluations and peer reviews, by which the organisations ensure that public-private arrangements meet various preset performance and quality criteria.

### **5.4 External reports: annual reports**

The Court analysed the annual reports and financial statements published by TNO (in 2001, 2002 and 2003), all the UMCs (in 2003) and 27 Regional Training Centres (2003) to see whether they contained information on public-private arrangements.



#### **5.4.1 Annual reports published by ROCs**

Most of the 27 ROCs reported on one or more aspects of public-private arrangements, as is required by law. Only one ROC failed to report on any single aspect of such arrangements. The level of detail provided varied considerably from one ROC to another, however. The institutions reported on one or more of the following aspects of public-private arrangements:

- alliances and shareholdings;
- legal separation by means of the incorporation of separate companies or non-profit-making foundations;
- contract teaching;
- investments of public resources in private-sector activities;
- customised projects.

The Ministry of Education, Culture and Science's 'Clarity' memorandum on adult and vocational education urges the ROCs to report in more detail in their annual reports on various aspects of public-private arrangements. The main topics on which information should be provided are investments of public resources in private activities and tailor-made projects performed for private companies. The ROCs were required to report on these issues as from the 2003 financial year, and indeed have done so. Nonetheless, there are wide divergences in the amount of information provided, with some ROCs reporting in detail and giving examples, and others providing very little information.

The ministry believes that it is up to each individual establishment to prove that it is operating efficiently, and to do so in a manner that is open to verification by an outsider. The Minister of Education, Culture and Science should be able to use the information supplied in the annual reports to form a general impression of the contract activities performed by the ROCs. However, the Minister is not able to assess the added value or efficiency gains generated by combining public tasks with commercial activities within one and the same organisation. The Minister cannot use the external reports published by the ROCs to verify the accuracy of assumptions about beneficial cross-fertilisation (whether in terms of quality or in financial terms) between public and private activities. Similarly, the Minister cannot use the information provided in annual reports to assess the risks associated with the combination of public tasks and contract activities.



### 5.4.2 Annual reports published by UMCs

The annual reports and financial statements published by the eight UMCs contain information on:

- developments and quantitative data in relation to patient care, teaching and research;
- the hospital's role in relation to on-the-job training, in the form of quantitative data on both funding parameters and costs;<sup>41</sup>
- the composition of their revenue; all individual financial flows are shown in the financial statements. A UMC can show how large its private financial flows are by breaking down all flows into 'public' and 'non-public' flows.

The annual reports do not contain any *substantive* information on contract research, although they do provide a certain amount of information on alliances with external partners (which did not fall within the scope of the Court's audit).

The Academic Medical Centre in Amsterdam was the only UMC to list the names of all its external sources of funding, although it did not specify the nature or value of the research projects in question. Interestingly, some UMCs have set up separate entities to handle research projects funded from external sources, whereas others have not. A number of UMCs have invested in companies founded by their own staff.

The information provided in the annual reports does not give the Minister of Education, Culture and Science and the Minister of Health, Welfare and Sport a full picture of the contract activities performed by the UMCs. The annual reports do not contain any information on the added value or efficiency of the contract activities.

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<sup>41</sup> This is used to designate the difference between a general and a university hospital. In other words, research is performed and students trained at the latter type of hospital.

**Twenty supervisory bodies: streamlining reporting information**

Government regulations mean that the LUMC is required to deal with at least 20 different supervisory bodies and has to submit one or more annual reports to eight of them, such as ministries and inspectorates. Whilst there are certain differences between these reports, there are also overlaps. The Ministry of Health, Welfare and Sport has launched a pilot project entitled 'Annual Social Report' the idea of which is to produce a single annual report in a common format that can be sent to a number of supervisory bodies. The LUMC is one of a number of parties from the healthcare sector that is taking part in the project. The participants will be using the agreed common format to produce their 'annual social reports' for 2004. This new document will replace the annual reports, staff annual reports, financial statements, quality-assurance annual reports, annual reports on complaints, the actual-cost forms compiled for the Healthcare Charges Board, the annual survey data and the standard set of performance indicators for the Healthcare Inspectorate. In other words, all the reporting information previously submitted in the form of separate documents to the Ministry of Health, Welfare and Sport, the Healthcare Charges Board, the Healthcare Inspectorate and the Ministry of Social Affairs and Employment has now been gathered together in the form of a single, new document.

**5.4.3 Annual reports published by TNO**

The information disclosed in the annual reports and financial statements published by TNO does not give the responsible ministers a picture of the efficiency of the organisation's spending, its social effects or impact, or the risks and opportunities presented by public-private arrangements. However, TNO is not under a statutory obligation to do so. The Ministry of Education, Culture and Science does not make any use of the reports compiled by individual TNO institutes and TNO Management BV, including those produced by spin-off companies. The Ministry feels that it would be difficult to do so, given the size and complexity of the TNO organisation.

Without being under any statutory obligation to do so, TNO does send the Ministry of Education, Culture and Science copies of audits performed at individual institutes containing assessments of their academic status, as well as levels of customer and staff satisfaction. In principle, the Ministry does not enter into correspondence with individual institutes, unless there are good reasons for doing so. Since 2001, the audits have been the



subject of talks between TNO representatives and officials from the Ministry of Education, Culture and Science.

For the past two years, TNO has been obliged to use indicators in reporting to the Minister of Education, Culture and Science. These are intended to enable the Minister to assess TNO's output and efficiency in broad terms, and do not provide any detailed information on each individual domain in which it is active. The Ministry has made clear that it does not believe the indicators are suitable for use in a dialogue on policy and for this reason does not use them for this purpose.<sup>42</sup> The Ministry believes that the indicators are in need of further refinement.

Following the amendment of the TNO Act in 2005, TNO is now obliged to include descriptions of its activities and policies in its annual report and financial statements, and also to state whether it has achieved the objectives set out in its strategic plan.

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<sup>42</sup> Report on evaluation of TNO indicators for 2003, 26 October 2004.



## 6 Supervision

### 6.1 Introduction

The Court of Audit examined the *internal* supervision of public-private arrangements by the supervisory boards of all three organisations under review (section 6.3), as well as the *external* supervision as exercised by the minister and/or the Inspectorate (section 6.4). The final section of this chapter is a discussion of the relationship between the internal supervision exercised by the supervisory board and the external supervision exercised by the minister or the Inspectorate (section 6.5).

### 6.2 General impression of supervision

#### *External supervision*

The government has given institutions the freedom to develop public-private arrangements, but has failed to create a clear system for the supervision of such arrangements. The Ministry of Education, Culture and Science's 'Clarity' memoranda on adult and vocational education and higher education are a first step in the direction of extending its supervisory mechanisms to include public-private arrangements and compliance with legislation concerning the use of public funds to finance private-sector activities. Actual supervision is marginal and sporadic in the case of the institutions of adult and vocational education and completely absent in the case of the UMCs. Where the performance of TNO and the LUMC is concerned, vertical supervision is supplemented by other forms of external assessment, such as benchmarking studies, peer reviews and various societal impact assessments. However, none of these reveal whether public-private arrangements contribute to the institutions' performance, and if so, how.

#### *Internal supervision*

The audit shows that, in practice, the supervisory boards of the organisations involved are alert to potential problems and receive the right information. In every case, however, the statutory status of the supervisory board proved to be inadequate. This is not a problem so long as things go well, but could become one if supervisory boards fail to do their job.



#### *Relationship between external and internal supervision*

In all three sectors under review, the minister is informed about the activities of the supervisory boards via the organisations' annual reports. However, this information gives the minister only a limited idea of how well each supervisory board is performing. In all three sectors, the role played by the supervisory board within the chain of supervisory responsibilities needs to be clarified. In particular, the division of roles and responsibilities between external and internal supervisory bodies could be more clear-cut. At present, the minister makes no use of the results of the work of the supervisory boards in her own external supervision of the sectors included in the audit.

### **6.3 Internal supervision: supervisory boards**

#### **6.3.1 Statutory framework**

The audit revealed an inadequate statutory framework for the supervisory boards in all three sectors under review:

- In the adult and vocational education sector, recognition of the growing importance of the role played by the supervisory board has not yet been followed by the creation of a sound statutory framework and effective arrangements for 'supervising the supervisors'.
- There is no formal statutory framework for the UMCs, as university hospitals are the only entities covered by the law. Moreover, the provision in the law stating that the supervisory board is accountable to the minister has had very little practical effect.
- It is not clear what role is played by TNO's supervisory board in the minister's supervisory arrangement with regard to TNO. The supervisory board is caught between two fires, serving both TNO's and the minister's interests.

In all three organisations under review, the supervisory board is the body to which the external auditors report. In the case of TNO, this is a matter that is explicitly regulated in the amended version of the TNO Act.



### 6.3.2 Focus on public-private arrangements

#### *ROC MN*

The supervisory board of the ROC MN has the following policy on contract activities: there should be a low level of risk, the activities should allow the Centre to offer a wide range of courses with an even distribution of risk, and there should be a clear distinction between public and commercial activities. The supervisory board takes the view that loss-making subsidiaries should be given a further chance to prove themselves but that, if they remain in the red, they should be wound up. The external auditors will be asked for their opinion before a decision of this nature is taken. The supervisory board believes that contract activities should produce certain benefits, mainly in the form of increased customer loyalty, a bigger market share (also for the institution's publicly funded courses), closer ties with private-sector firms, higher returns and a stronger spirit of enterprise among the teaching staff, so that the organisation can respond better to market demands and develop a capacity for innovation.

The supervisory board realises that it is undesirable for the organisation's contract activities to be loss-making in the long term:

'This leads to a situation in which contract activities are financed by public resources in the long term. For both business reasons and reasons of good governance, this is no longer desirable.'<sup>43</sup>

Various aspects of public-private arrangements were discussed at supervisory board meetings in 2003 and 2004.<sup>44</sup> The supervisory board intervenes if its members believe that action is required in order for the board to perform its supervisory role. For example, the supervisory board backed instructions given by the management board for the Centre's contract activities to be reorganised and urged the management board to set out its views on the future of the ROC MN's contract activities. These views were set out in a memorandum presented to the supervisory board in December 2004. The memorandum announces a review of the structure and performance of the Centre's contract activities in 2006.

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<sup>43</sup> Instructions from management board, ref. 0405.

<sup>44</sup> Among the topics discussed were financial reports, the budget and annual reports, the merger of the Utrecht ROC and the Amerlanden ROC, the accommodation plan, the report compiled by the Schutte Committee and the reorganisation of the ROC's contract activities.



### *LUMC*

The Court found that the supervisory board discussed a large number of subjects that have a bearing on public-private arrangements, such as non-profit-making foundations, licences and patents, alliances, risk management and asset management. At the same time, public-private arrangements are not in themselves a topic of discussion for either the supervisory board or the LUMC's audit committee.

The management aspects of research projects funded by external clients, outside activities and conflicts of interest are not issues that are dealt with by the supervisory board and/or the audit committee. The supervisory board takes the view that such matters fall within the competence of the management board.

The supervisory board and the management board are agreed that the LUMC should not run any business risks by undertaking activities funded by external clients, and that any staff who wish to start their own businesses based on LUMC-related activities should resign from their jobs with the LUMC.

### *TNO*

TNO's supervisory board believes that staff should be afforded opportunities to undertake commercial activities. At the same time, the supervisory board believes there are limits on the amount of freedom staff should be given, although it is not easy to define these limits with any degree of precision. Acknowledging TNO's hybrid nature is critical in this respect, the supervisory board feels. Because there have not been any major problems or failures in recent years, the supervisory board concludes that hybridity is not a problem in practice. Although the supervisory board is not concerned specifically with public-private arrangements, it is aware of the potential dilemmas associated with such arrangements, such as those sparked by the need to choose between social and commercial interests. The supervisory board has not formulated any views as to its own role in relation to these dilemmas and to the long-term objectives that mixed public-private activities should be expected to meet.



### *General*

The general picture is that supervisory boards are not supplied with information relating specifically to public-private arrangements as such. At the same time, the three supervisory boards under review do discuss matters that have a bearing on such arrangements.

## **6.4 External supervision: the minister**

The Court of Audit assessed the nature of the external supervision exercised by the minister or by a regulatory authority or inspectorate acting on the minister's behalf. The Court also examined whether external supervision also involves the supervision of public-private arrangements.

### **6.4.1 External supervision of ROCs**

The Minister of Education, Culture and Science is responsible for supervising the enforcement of statutory rules and regulations. She has a duty to ensure that the education budget is distributed in such a way that it makes the maximum contribution towards the attainment of the government's educational policy goals. All ROCs are required to submit copies of their financial statements to the Central Institutions Funding Agency (CFI) at the Ministry of Education, Culture and Science. The CFI agency reported that the financial statements for the financial years up to and including 2002 contained very little information on contract activities. Since 2003, the publication of the 'Clarity' memorandum has meant that it is now possible to collect information on this subject on a more systematic basis.

In 2003, the Minister of Education, Culture and Science extended her supervisory activities to include public-private arrangements, at least in theory.<sup>45</sup> In practice, these issues are subject only to marginal supervision, whilst the inspectorates undertake only sporadic examinations in the specific field of public-private arrangements.

The Audit Department at the Ministry of Education, Culture and Science claims that the requirements set out in the 'Clarity' memorandum do not yet offer sufficient practical guidelines for audits of public-private arrangements. It will be undertaking a marginal assessment of certain aspects cited in this memorandum as part of its 2003 review. The

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<sup>45</sup> The two main issues examined by the Minister are tailor-made courses and compliance with the law on the investment of public funds in private-sector activities.



contents of the 'Clarity' memorandum have indeed been included in the audit guidelines for 2003.

The Court of Audit found that the way in which supervision is currently exercised (i.e. by the Ministry's Audit Department, the Policy Departments and the Education Inspectorate) does not generate any information on the extent to which public-private arrangements help ROCs to achieve their policy objectives, such as improving the ability of publicly funded courses to prepare students for the demands of the job market.

#### **6.4.2 External supervision of UMCs**

Every year, the CFI agency at the Ministry of Education, Culture and Science assesses the financial statements compiled by the universities. This analysis of the financial situation at each university is intended for internal use at the Ministry. In addition, the Ministry's Audit Department has the right of access to all university hospitals and UMCs, and may be instructed to perform an efficiency audit (under section 2.10 of the Higher Education and Research Act). This involves assessing the way in which the organisation in question has spent the government grant. No efficiency audits have been performed in recent years, and in any event not since 1998, as the Ministry has not seen any reason to do so.

The Minister of Education, Culture and Science supervises the way in which university hospitals and UMCs spend the government grant for teaching and research. The Minister of Health, Welfare and Sport also supervises the quality of the patient care services provided by the university hospitals and UMCs, which it does by means of the inspections performed by the Healthcare Inspectorate.

The supervisory activities performed by the Minister of Education, Culture and Science and the Minister of Health, Welfare and Sport do not include monitoring the prevalence of public-private arrangements and assessing the degree to which they help the organisations concerned to achieve their policy objectives.

#### **6.4.3 External supervision of TNO**

The Minister of Education, Culture and Science plays a special role with regard to TNO, acting in a supervisory capacity monitoring the spending of budget resources and also managing relations with other ministries



that have links with TNO. She is responsible for the regularity and efficiency of public spending.

In addition, as part of the supervision exercised by controllers at the Ministry of Education, Culture and Science, talks are held between TNO and the Ministry on operational management at group level (i.e. management board and supervisory board). The Minister of Education, Culture and Science bases her opinion on TNO's consolidated financial statements.

The Minister of Economic Affairs also supervises TNO, and takes a special interest in specific-purpose funding. The Minister uses two indicators to this end:

1. the contribution made by cofinancers to research projects;<sup>46</sup>
2. the number of small firms taking part in research projects.

TNO's financial statements are audited by an external auditor. The Ministry of Education, Culture and Science has drawn up audit guidelines to facilitate these audits. The amended version of the TNO Act states that the auditor's report should include an opinion on the regular collection and spending of public funds.<sup>47</sup> The Ministry is entitled to review the audit performed by the organisation's internal audit department. The next review planned relates to the 2004 financial year.

The Audit Department at the Ministry of Education, Culture and Science has yet to audit the public-private activities performed by TNO and TNO's system of cost accounting. The Ministry is, however, entitled (should it receive the appropriate signals) to instruct the Audit Department to perform an operational audit in relation to these matters.

The public-private activities performed by TNO are not in themselves a special topic of interest. The supervisory role performed by the ministers does not result in their being informed about the advantages and disadvantages of TNO's hybrid nature. At the same time, the government instructed the Wijffels Committee to perform a review of TNO and the big technological research institutes. The government subsequently endorsed the recommendation made by the Committee for TNO to adopt a more demand-driven approach to its work.

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<sup>46</sup> The ministry has set a target of 40% of aggregate funds to be supplied by cofinancers.

<sup>47</sup> See Bulletin of Acts and Decrees 2005, no. 47. The amended TNO Act came into force on 1 January 2005.



TNO does, however, keep the Ministry of Education, Culture and Science up to date with any developments affecting its academic status in each individual discipline. TNO finds out about its status through the results of international peer reviews. The Court wishes to stress that what the Ministry of Economic Affairs and the Ministry of Education, Culture and Science know about the organisation's economic impact is based largely on perceptions and expectations emanating from the private sector.

## 6.5 Relationship between internal and external supervision

In a paper setting out its views on a framework for supervision, the government made clear that supervisory boards '*... cannot in any event replace the vertical supervision exercised by or on behalf of a minister*'.<sup>48</sup> The view taken by the Court in this connection is that, although a supervisory board cannot replace the vertical supervision exercised by a minister, ministers are entitled, subject to strict conditions, to make use of the results of the supervision exercised by a supervisory board.<sup>49</sup>

The Council for Adult and Vocational Education decided to task a committee (known as the Meijerink Committee) with compiling a governance code setting out certain views on the relationship between internal and external supervision in vocational education.<sup>50</sup> The Committee has urged the government to extend the Adult and Vocational Education Act to incorporate provisions for a governance structure involving a management board with full managerial powers operating alongside a supervisory board. The Act should also contain clear provisions on the respective responsibilities of both boards. The Committee has pointed out that, under the current Adult and Vocational Education Act, the government has no powers to intervene in the event of the failure of the system of management and supervision at an institution providing adult and vocational courses. Finally, the Committee has underlined the need to strike the right balance in the amount of information provided to the government.<sup>51</sup>

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<sup>48</sup> House of Representatives, 2000-2001, 27 831, no. 1.

<sup>49</sup> These conditions would include ratifying the quality of the supervisory information and assuring both the quality and the independence of the supervisory board. See: Court of Audit, *Accounting by and Supervision of Legal Persons with Statutory Tasks*, Part 4, pp. 38-43. House of Representatives, 2003-2004, 29 450, nos. 1-2.

<sup>50</sup> Committee on Governance in Institutions of Adult and Vocational Education (Meijerink Committee), *Educational governance bij BVE-instellingen*, 2005, pp. 27-28.

<sup>51</sup> Committee on Governance in Institutions of Adult and Vocational Education, p. 27.



Supervisory boards at institutions providing adult and vocational education are set up on the initiative of the institution concerned, rather than to satisfy certain statutory obligations. The minister does not use the results of the supervisory activities performed by supervisory boards at institutions of adult and vocational education in exercising her vertical supervision of the sector.

The Court concludes that the LUMC's supervisory board reports on its activities in the form of a report accompanying the LUMC's financial statements. There has not yet been any instance in which the Minister has asked for further information about the operation of the supervisory board. Regarding the system of reporting to the Minister, the Court notes that, in practice, the information provided in the annual report is the only form of compulsory reporting to the Minister. This means that the Minister is supplied only with relatively sketchy information on the board's views about its own role and working methods. The Minister would need to obtain additional information in order to form a picture of the way in which the supervisory board operates, for example, in supervising public-private arrangements.

As far as TNO is concerned, the Court feels it is unclear who is the Minister's first point of contact, i.e. the management board or the supervisory board. Similarly, the TNO Act does not make clear to whom the supervisory board should report, i.e. is the supervisory board accountable to TNO itself, or to the Minister? As a result of this confusion, it is not clear whether the relationship with the supervisory board forms part of the system of supervision exercised by the ministry. TNO's supervisory board has the following to say on this point:

'... key aspects of the board's powers, such as the supervision of the management board and financial supervision, have been regulated in a half-hearted and inconsistent fashion. Due to the nature of its role, a supervisory board has a duty both towards the Minister and towards its own organisation.'<sup>52</sup>

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<sup>52</sup> Letter to Court of Audit (2005 ED 05), 31 January 2005.



## 7 Conclusions

### 7.1 Introduction

The recurring theme emerging from this audit is that reporting on added value – as is clearly generated in certain areas – remains inadequate, and that both internal and external supervisory bodies do not display a great deal of interest in risks and the generation of added value. The audit has also revealed that neither the government nor the organisations under review have a systematic set of criteria for assessing the rationale for, the structure of and the effectiveness of public-private arrangements.

The audit findings lead to a number of conclusions for the organisations under review. These relate to issues that apply on a broader front than simply to the organisations and sectors implicated in the audit.<sup>53</sup>

### 7.2 Opportunities and objectives not always clear

It is not always clear when an organisation may be regarded as a government body and when as a private enterprise. One of the characteristic features of organisations combining public tasks and public funding with private activities and private funding is that, in many cases, they may be classified both as government bodies and as 'undertakings' as defined by the Dutch Competitive Trading Act. In other words, one part of the organisation may be classified as a commercial undertaking, whilst another part is classified as a government body. The point is that

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<sup>53</sup> For example, aspects such as enterprise, opportunities, objectives, operational management, added value, supervision and reporting are all topical issues in other sectors. See for example:

- Advisory Council on Government Policy, *Bewijzen van goede dienstverlening* (2004);
- Social and Economic Council, *Ondernemerschap voor de publieke zaak* (2005);
- the plans for statutory rules for public bodies operating in the private sector (Ministry of Economic Affairs);
- the 'governance in the educational sector' project (Ministry of Education, Culture and Science);
- the report entitled 'Eerlijk delen II' published by the Committee for Further Research into Accountability (the Schutte Committee, 2005).



government bodies and commercial undertakings are governed by different laws.

Partly because key aspects of the relevant legislation have yet to crystallise (as in the case of the statutory rules for public bodies operating in the private sector announced by the Ministry of Economic Affairs and the EU Services Directive) and because industry codes of conduct are not clear about certain issues, it is difficult to identify a general framework for public-private arrangements.

The audit shows that, whilst the organisations under review have a certain degree of freedom in which to operate on a commercial basis, it is not always clear what sort of effects this freedom is intended to produce and what the added value of these effects should be. For this reason, it is sometimes difficult to identify the object of public-private arrangements and to measure the extent to which they contribute in practice to the attainment of the organisation's objectives.

### **7.3 Operational management still deficient**

Both the EU (in the form of the Transparency Directive, the competition rules, the Services Directive, the ban on state aid and the rules on public procurement) and the Ministry of Economic Affairs (in the form of the plans for statutory rules for public bodies operating in the private sector) stress the need for 'public-sector undertakings' to avoid any form of unfair competition (for example, as a result of cross-subsidisation). In order to rule out this possibility, such undertakings should ensure that their operational management is both orderly and auditable and that their organisational structure is transparent. In addition, the external reports published by these undertakings should contain clear information on both public and private sources of revenue and on activities performed in both the public and the private sector.

Basically, the organisations in question are aware of the size of incoming flows of public and private resources. Information is also available on the way in which these resources are spent. However, there is room for improvement and a greater degree of transparency in aspects such as the way in which the cost is calculated, the attribution of costs and the breakdown of the price that is charged to customers. Neither the ROC MN nor the LUMC has a clear idea of the actual number of hours spent on the various contract activities (as recorded by a timekeeping system, for example). This means that it is not always possible to see from the records kept whether there has been any form of cross-subsidisation.



A debate is ongoing, at both the institutions of adult and vocational education and the UMCs, as to the ideal organisational structure for forms of public enterprise, i.e. should a separate subsidiary be set up to handle all contract activities? Different organisations take different views as to the pros and cons of founding a separate company for this purpose, in terms of the desired level of synergy, the financial aspects (e.g. corporation tax and VAT) and the scope for employing staff on more flexible terms of employment.

## 7.4 Little evidence of added value

Whilst both the government and the organisations under review expect contract activities to generate considerable added value, there are very few hard figures available on the degree to which and the way in which public-private arrangements help raise the standard of public service or make any other vital and valuable contribution towards the future viability of the organisation in question. There is scope for improving both the management and the transfer of intellectual property in the organisations under review.

There are different types of added value: financial benefits, benefits to corporate culture, added value in terms of public services and added value for society as a whole.

The audit revealed that two of the three organisations under review gained certain *financial benefits* from contract activities. The Court wishes to point out, however, that whether a given activity makes a profit or a loss depends on the items included in the cost-allocation formula. This varies from one organisation to another, and sometimes even from one department or product to another.

As regards benefits in terms of *corporate culture*, the Court's impression is that, although the staff of the organisations under review set considerable store by their public mission and their terms of employment,<sup>54</sup> they have no objection to adopting an entrepreneurial approach to their work – in the sense of being innovative and creative. The management would appear to be more interested at present than staff in adopting flexible terms of employment that reflect current

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<sup>54</sup> Although the Court did not systematically examine this particular aspect, it was cited by all the organisations under review as being an important form of added value.



practices in the marketplace. Changing the corporate culture appears to be an end in itself in some cases.

The Court found examples to support the view that contract activities benefit *public services*. These include improvements made to the curriculum in a particular subject and research projects that can be undertaken only if private funding is forthcoming. Nonetheless, both the internal and external reports have very little to say about the actual impact that contract research and teaching have on the standard of public services.

Both the government and the organisations under review cite '*added value for society*' as one of the main objectives of private-sector activities. The Court found a number of cases in which attempts had been made to encourage the achievement of this objective. Apart from being reflected, for example, in the organisation's mission, certain organisations have attempted to express this added value in the form of 'societal impact indicators'. The organisations' external reports contain hardly any information on the added value for society.

The Wijffels Committee recently investigated the added societal value generated by research institutes. The members of the Committee had a number of critical comments to make about the existing arrangements. The added societal value generated by the UMCs should be reflected by their contribution to scientific research and by the beneficial impact that research findings have on patient care services. However, data are not collected systematically on this type of added value.

The added value for society generated by the Regional Training Centres is primarily a matter of improving the way in which students are prepared for the demands of the job market. Contract activities are one way of achieving this.

## **7.5 Reports do not say much about added value**

### **7.5.1 Internal reports**

The organisations under review were able to produce plenty of internal reports on contract teaching (in the case of the ROC MN), contract research (LUMC), mixed public-private projects (TNO) and privatisation projects (TNO). Most of the information provided in these reports concerns the nature and scale of public-private arrangements and their financial results. Information on the degree to which public-private



arrangements help the organisation in question achieve its mission or strategic objectives is not provided as a routine aspect of the internal reporting cycle.

Two of the three organisations under review (i.e. the LUMC and TNO) do perform an assessment, before starting a given contract activity, of whether private-sector activities, private funding and alliances with private-sector parties are consistent with their long-term research policies. There are also other ways, such as evaluations and peer reviews, by which the organisations ensure that public-private arrangements meet various preset performance and quality criteria.

### **7.5.2 External reports**

All the annual reports examined by the auditors complied with the statutory requirements relating to the aspects under review. Although the organisations do provide some information on their public-private arrangements in their published annual reports, the amount of information and the level of detail vary widely.

The information contained in the annual reports published by the organisations under review is not sufficient to justify any conclusion as to whether their public-private arrangements contribute to a beneficial cross-fertilisation between their public-sector and private-sector activities. Their annual financial statements and annual reports proved to contain very little explicit information about the potential added value of public-private arrangements and the way in which the pertinent risks are controlled.

The Court believes that this is a wasted opportunity to inform stakeholders about risks, ways of dealing with risks, strategic decisions, financial benefits and added value for society. It would also be easier for a supervisory authority (such as the Education Inspectorate) to assess the level of risk if standardised – and therefore more easily comparable – information were available on the risks and opportunities associated with contract activities.



### **7.5.3 Limited information on factors taken into account by management**

The publication of reports and the exercise of supervision by an external supervisory authority are both ways of ensuring that organisations perform properly and improve their performance. However, they are not the only ways of doing so. They are part of a wider system of internal supervision, quality assurance (i.e. internal quality assurance systems, benchmarking and peer reviews) and interaction with stakeholders. This is a particularly important factor for hybrid organisations, given that they are likely to have a wide range of both public-sector and private-sector stakeholders whose interests and desires may well be diametrically opposed to each other. The risk of a clash of philosophies, corporate cultures and staff attitudes to quality and efficiency is greater than in the case of public corporations. Whereas state organisations can always fall back on the statutory definition of their object, organisations combining public tasks and public funding with private activities and private funding do not have such a clear point of reference. This means that the point of reference taken when examining this type of organisation is the way in which the management constantly seek to strike the right balance between the public interest and the organisation's statutory task on the one hand, and the interests of staff and stakeholders on the other.<sup>55</sup> The Court found that there was room for improvement in the auditability and transparency of the factors taken into account by the management in reaching a decision in this connection.

## **7.6 Weaknesses in supervision**

### **7.6.1 Internal supervision**

The Court found that the statutory basis underlying the supervisory boards was inadequate in all three organisations under review. Supervisory boards are not supplied with information relating specifically to public-private arrangements as such. At the same time, the three supervisory boards under review do discuss matters that have a bearing on such arrangements.

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<sup>55</sup> See also Social and Economic Council: *Ondernemerschap voor de publieke zaak*, The Hague, 2005.



### **7.6.2 External supervision**

The supervisory mechanisms used by institutions of adult and vocational education and the UMCs do not generate a great deal of information on the effects of public-private arrangements on the standard of public services, or on the ability of the organisations concerned to achieve their policy objectives. At TNO, public-private arrangements form part of the public task on which the organisation is required to report to the minister.

The audit also revealed examples of other forms of external supervision that provide information on the benefits of public-private arrangements, such as benchmarking studies, peer reviews and societal impact assessments.



## 8 Recommendations

The Court of Audit makes recommendations to industry associations, umbrella organisations, the Minister of Education, Culture and Science and organisations with public-private arrangements. Just like the conclusions, the recommendations have been formulated in non-sector-specific terms, given that the issues addressed by this audit affect a wider target group than just the sectors and organisations under review.

### 8.1 Recommendations made to the Minister of Education, Culture and Science

**First recommendation: Develop a clear legal framework for public entrepreneurship: provide clear guidelines about the opportunities and objectives**

The Court of Audit recommends the minister to develop a clear legal *framework establishing the principles of public entrepreneurship* and to provide the clearest possible guidelines, for those sectors encouraged to adopt public entrepreneurship, about the conditions applying to public entrepreneurship (i.e. the scope) and its ultimate objectives.

Acting in concert with the organisations concerned, the Minister of Education, Culture and Science should make clear in advance exactly who she expects to benefit from public entrepreneurship and what form of added value public entrepreneurship is expected to generate.<sup>56</sup> This could then form a point of reference against which to measure the performance of the organisations concerned. Only if this is done will it be possible to say whether entrepreneurship has been a success and whether it helps to raise the standard of public services or produce the desired societal

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<sup>56</sup> This recommendation is consistent with the government's view that the establishment of a clear framework is a critical condition for the creation of opportunities for public entrepreneurship. The government also takes the view that it should create frameworks and set objectives for the educational sector, and offer it policies and scope (see: House of Representatives, 2004-2005, 29 362, no. 32, Government response to report from Advisory Council on Government Policy, *Bewijzen van goede dienstverlening*).



effects. In this connection, the Court urges the government to continue work on a system of societal impact indicators.

***The Court regards the following as forming the basic requirements for a framework for public entrepreneurship:***

- Private activities must be connected with the organisation's public task and may not be at the expense of public services.
- Action must be taken to minimise the risk of the leakage of public funds and of cross-subsidisation. This should be evidenced by a transparent and orderly form of operational management.
- No distortion of competition is allowed; the organisation in question must be able to demonstrate that it is not distorting competition.
- The framework should clearly define the financial limits of public entrepreneurship. The government could indicate the circumstances in which losses could be incurred, how great these could be and for how long a loss-making situation could be allowed to persist.
- The framework for public entrepreneurship should include a provision compelling the organisations concerned to specify the type of added value they wish their public-private arrangements to generate.

The framework for public entrepreneurship should allow some scope for diversity in implementation. The current strategy documents for the educational sector, such as *Koers BVE* ('The future of adult and vocational education') and the 'Clarity' memoranda on adult and vocational education, could be even clearer in certain respects about the added value which public-private arrangements are intended to create, and could also play a stronger role in the supervisory arrangements.

**Second recommendation: Supervision should include a greater focus on public-private arrangements**

External supervisory bodies do not display a great deal of interest in the contributions made by public-private arrangements to the performance of the organisations in question, the risks entailed by public-private arrangements in relation to public funds and public services and the way in which they are managed by the organisations concerned. The supervisory authorities should pay greater attention to these aspects, with the aim of optimising the benefits of such arrangements and minimising their risks.



The annual reports should contain relevant information on the above points.

**Third recommendation: Supervisory boards should be given statutory status**

Organisations where public-private arrangements are in operation are required to reconcile their statutory tasks with business considerations and the interests of their customers, supervisory bodies and politicians. The supervisory board has a pivotal role to play in monitoring the way in which all these interests are weighed up against each other. It is important to bear in mind that the interests of the organisation are concerned are paramount in this respect. The supervisory board is the only body that is capable of overseeing all public-sector and private-sector activities and forming a judgement on the policy and business-related factors taken into account by the management.

Because of the vital role played by supervisory boards in the supervisory chain, the Court of Audit urges the government to give them a firm statutory status and also to make arrangements to provide for a situation in which a supervisory board fails to perform adequately.

**Fourth recommendation: The Minister should urge industry associations to include provisions on operational management and added value in their industry codes**

A study of the various industry codes reveals that they have so far paid little attention to operational management and added value, even though they are essential to public entrepreneurship and public-private arrangements. The codes could be extended to include provisions on an orderly and transparent form of operational management, as well as provisions calling upon organisations to provide full information on the risks, the way in which these are managed and on the added value, both projected and actual, of entrepreneurship in general and public-private arrangements in particular. The Court recommends the Minister of Education, Culture and Science to urge industry associations to include provisions on operational management and added value in their industry codes.



## 8.2 Recommendations made to organisations with public-private arrangements

### **Fifth recommendation: Organisations should publish information explicitly explaining their ideas about public entrepreneurship**

'Ordinary' entrepreneurs are expected to compile a business plan setting out their plans for potential lenders, explaining the risks involved and stating the projected costs and revenue. Public-sector bodies do not generally need to find sources of finance in order to perform private-sector activities, or to deal with the problems typically encountered by business start-ups. For this reason, it is reasonable to expect public entrepreneurs to draw up a document setting out their long-term plans and including revenue and cost projections, a risk analysis and an explanation of the risk-control measures taken in relation to public-private arrangements. The document should also explain the link between public-private arrangements and the public task performed by the organisation in question. This information should make it easier for internal and external supervisory bodies to judge whether the organisation concerned has achieved its objectives and managed its risks. The Court suggests that public enterprises should be obliged to compile this type of document, i.e. a pseudo-business plan.

### **Sixth recommendation: Public entrepreneurship calls for transparent, orderly and auditable operational management**

The operational management of a public enterprise should provide clear evidence of all items of expenditure and revenue, and should show that the organisation in question is not distorting competition. This means that organisations should be able to provide information on both costs and prices. The system of operational management should also satisfy European legislation. The Court believes it should be clear what private funding is supporting the implementation of public tasks and, vice versa, what public resources are being used to support private activities.

Guarantees relating to conflicts of interest and outside activities, as well as accounting procedures and measures relating to the organisational structure, can also help to enhance ethical standards and boost transparency.



### **Seventh recommendation: Reporting on public-private arrangements should be improved**

There are huge discrepancies in the information on public-private arrangements included in the reports published by the organisations operating in the sectors under review, which makes it difficult to make comparisons between them or to use them for benchmarking purposes. In order to increase the potential for benchmarking – and hence the learning opportunities – the Court of Audit recommends that annual reports should contain more, and more systematic, information on the nature, scale, benefits (both projected and actual) of and the risks associated with public-private arrangements. More information should also be provided on how such arrangements benefit public services.

The Court of Audit recommends that organisations should ensure that the reports they publish define the relationship between their public task, mission, long-term objectives (i.e. strategy), annual targets and the extent to which public-private arrangements contribute to the achievement of these aims. This would constitute a further major advance in the process of moving from blind trust to accountability on the part of organisations that undertake public enterprise in the form of public-private arrangements.

### **Eighth recommendation: A checklist for public-private arrangements**

This Court has examined the practice of public-private arrangements from four different perspectives: operational management, added value, reporting and supervision. The Court concluded in Chapter 2 that these four aspects were not comprehensively covered by the legislation and industry codes. The Court has devised a checklist that institutions can use to gain a quick impression of their own performance in a number of important areas relating to public-private arrangements. This checklist is given in Annexe 2.

Public entrepreneurship





## 9 Responses of organisations and ministers, and Court of Audit's afterword

### 9.1 Introduction

The Court of Audit asked the governing boards of the organisations under review and the three ministers concerned to respond to the draft report. The main points of these responses are set out below. The full text of the letters received may be consulted on the Court's website ([www.rekenkamer.nl](http://www.rekenkamer.nl)). Annexe 3 contains a full summary of the responses to the conclusions and recommendations, and also of the Court's afterword. The draft report was clarified and amended at various points in response to the responses.

### 9.2 Responses of organisations under review

#### 9.2.1 Regional Training Centre for the Central Netherlands (ROC MN)

The response from the governing board of the ROC MN includes a discussion of the measures it is currently taking with regard to cost accounting, the charging of overheads and the harmonisation of administrative systems in order to identify and control the leakage of public resources. The ROC MN has adopted the principle of passing on the full cost to its customers. Guidelines for the calculation of cost prices have now been incorporated in an accounting manual. The ROC MN accepts the Court's recommendations on the way in which the risks associated with public-private arrangements should be managed, and has incorporated these in its process improvement programme. The ROC MN does not accept the comment made in the report that it would make it easier for a supervisory body (such as the Education Inspectorate in the Netherlands) to assess the degree of risk if it were provided with standardised information on the threats and opportunities associated with public-private arrangements. The governing boards points out that not all units have incurred accumulated losses.



On the issue of ethical standards (as part of operational management), the governing board refers to the recommendations made by the Meijerink Committee. This autumn, the ROC MN will be adopting a governance model based on these recommendations.

The ROC MN agrees that the supervisory boards need to be given statutory status. It also accepts the desirability of adopting a set of societal impact indicators, and would be willing to contribute to the debate on this.

The ROC MN agrees with the conclusion drawn by the Court that a framework or code is required alongside documents such as *Koers BVE* ('The future of adult and vocational education') and the 'Clarity' memoranda on adult and vocational education. The governing board believes that such a framework or code should take the form of 'a binding code of governance drawn up by the sector in consultation with the Ministry of Education, Culture and Science'.

Finally, the governing board points to the increasing pressure that is being brought to bear on the supervisory chain and argues for standardised reporting documents and a comprehensive supervisory framework. The latter would make it easier to harmonise the work performed by the internal audit department, the Central Institutions Funding Agency (CFI) and the Education Inspectorate. The governing board believes that an independent body (such as the Commercial Chamber) could mediate in and settle any disputes about the enforcement of the code of governance.

### **9.2.2 Leiden University Medical Centre (LUMC)**

The board of the LUMC sees no need to comment on the contents of the report.

### **9.2.3 TNO**

In his response to the draft report, the chairman of TNO's management board points out that TNO's private-sector activities are not performed in addition to its public task, but that the intermingling of public and private activities is one of the organisation's characteristic features. Regarding the conclusions and recommendations in relation to operational management, TNO says that it uses a pure costing system and that, in some cases (such as in connection with the system of grants awarded for investments in the knowledge infrastructure), it is obliged to charge less



than the cost price. In this connection, TNO urges the Minister of Education, Culture and Science to ensure that research institutes, both in the Netherlands and in Europe, operate on a level playing field.

TNO welcomes the Court's conclusion that, broadly speaking, its operational management is adequate in relation to the aspects under review. TNO believes that the operational management pursued in relation to patents, licences and privatisations is also up to standard. Nonetheless, TNO would like to see the general guidelines and rules applying to public-sector and private-sector organisations in a process of privatisation fleshed out in more detail in 2005. Documentation will be one of the aspects of this.

TNO intends to undertake a critical analysis of its licence management procedures with a view to identifying opportunities for improvement. It will be important to strike the right balance between the need for documenting processes and the cost of doing so, given the aggregate revenue earned from licensing contracts.

On the issue of added value, TNO intends to increase its added value and make it easier for others to see. An improvement programme has been drawn up to this end, which has been discussed with the Minister of Education, Culture and Science. In accordance with the Court's recommendations, TNO's annual reports will contain clearer information on its added value to society. For example, the annual reports will henceforth include the reports sent to the Minister under the terms of the 'Tailor-made Indicators Covenant'.

Given that societal added value is difficult to express in figures, some of the information included in the reports will be of a qualitative nature, and will where possible be supplemented with quantitative data. In accordance with the Court's recommendations, TNO is already using societal impact indicators.

As regards added value in terms of staff attitudes and corporate culture, TNO agrees with the Court that culture change is not an end or a form of added value in itself, but rather a necessary condition that needs to be fulfilled if the organisation is to make more of an impact on its target groups. This will be one of the points to be taken into consideration when TNO implements its improvement programme.

TNO accepts the point made by the Court that the powers and responsibilities of its supervisory board have not been clearly defined.



Agreement has been reached with the education minister that TNO's supervisory board will present a proposal in December 2005 for clarifying its status, tasks and powers. One of the points to be borne in mind is that the Minister should be able to make better use of the results of internal supervision for the purpose of exercising her external supervision.

### **9.3 Response of Minister of Education, Culture and Science**

Writing with the support of the Ministers of Health, Welfare & Sport and Economic Affairs, the education minister broadly endorses the conclusions and recommendations set out in the draft report. She points to a number of developments and recently published documents which are in line with the recommendations contained in the report. She refers to the following documents: the 'Clarity' memoranda on educational funding, the regulations on investment and borrowing, the amended guidelines on annual reports, the tightening up of the audit guidelines and two documents she recently sent to the House of Representatives, viz. *Governance in het onderwijs* ('Governance in education') and *Verantwoording inzet publieke middelen* ('Accounting for the use of public funds').<sup>57</sup>

There have also been a number of developments in the healthcare sector to which the Minister refers in her response that have a bearing on public-private arrangements. A Healthcare Institutions (Accreditation) Bill has been drafted, as has a draft implementation decree for the bill. Among the points covered by these documents are the status of the supervisory boards of healthcare institutions and standards of operational management. In addition, the industry associations for the healthcare sector published a sector-wide governance code in June 2005. The Healthcare Charges Board has adopted a policy on supplementary sources of income earned by healthcare institutions, in which various conditions are set out that revenue earned from care-related activities is required to satisfy.

In response to the Court's recommendation that the government should publish a general framework establishing the principles of public entrepreneurship, the ministers claim that the statutory rules for public bodies operating in the private sector are intended to do just that.

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<sup>57</sup> *Governance in het onderwijs*, House of Representatives, 2004-2005, 30 183, no. 1, 7 July 2005. *Verantwoording inzet publieke middelen*: letter of 20 July 2005 from the State Secretary for Education, Culture and Science to the House of Representatives, ref. HO/CBV/05/22162.



In response to the recommendation that supervisory mechanisms should focus more on public-private arrangements (at least, more than is currently the case), the Minister of Education, Culture and Science comments that the government's prime interest lies in delivering public services. Private-sector tasks may be performed alongside these public services, provided that the former do not impede the latter and provided that public funds are used in accordance with the rules set out in *Verantwoording inzet publieke middelen* ('Accounting for the use of public funds'). The regulations set out in the 'Clarity' memoranda on educational funding and the guidelines on annual reports will be adjusted: organisations will be required to include in their financial statements relevant information on the added value generated by public-private arrangements and the risks potentially associated with such arrangements.

The ministers wish to allow the industry representative bodies to decide for themselves as to whether their industry codes should contain provisions on operational management and added value. The recently published code of conduct for the healthcare sector includes a provision to the effect that management boards should report to and discuss with supervisory boards matters relating to internal risk management and the control system.

The Minister of Education, Culture and Science shares the Court's view that organisations should formulate a clear philosophy on public entrepreneurship. She stresses that organisations can arrive at carefully considered decisions only after consulting their stakeholders. The publication of information on their long-term policies should form part of this process. The Minister is not prepared to oblige the organisations to publish information of this nature, as she believes it is up to the supervisory boards to take the next step.

The Minister agrees with the Court that public enterprises should invest more money in transparent, orderly and auditable systems of operational management. She wishes to make clear that a great deal of improvements have already been made in the recent past. She states her intention of meeting industry representatives to discuss the opportunities for making further improvements, based on the findings of the audit of higher education and adult and vocational education performed by the Ministry's Audit Department. She also points to the requirements relating to the transparency of operational management included in the Healthcare Institutions (Accreditation) Bill.



Responding to the recommendation to improve reporting on public-private arrangements, the Minister refers to the document entitled *Verantwoording inzet publieke middelen* ('Accounting for the use of public funds'). She also refers to the regulations on annual reports published by healthcare institutions, which encourage the latter to report on their activities to the outside world.

The Minister feels that the Court's checklist for public-private arrangements is a good idea, providing as it does a set of practical guidelines.

#### **9.4 Afterword of Court of Audit**

The Court of Audit is pleased to see that both the ministers concerned and the organisations under review have welcomed the report, and that they broadly agree with the arguments and recommendations.

The Court concludes that the organisations under review are taking action in line with the recommendations in a wide range of areas.

It is clear from the response of the Minister of Education, Culture and Science that a great deal has already been done to tighten up and clarify the legislation on public-private arrangements. This action has led to the production of a large number of guidelines and framework documents. Whilst the Court agrees with the Minister that sector-specific rules are required, the current situation is that a large number of documents are published for each individual sector in the field of education. This fragmentation makes life more difficult for the organisations, particularly given that some of these documents are updated every year. For this reason, the Court endorses the ROC MN's call for greater uniformity in the documents setting out the reporting requirements imposed on the various organisations.

The Minister of Education, Culture and Science believes that the supervisory boards have an important role to perform. This includes assessing investment plans in which public resources are used to fund private-sector activities. The Court of Audit points out that the education minister has failed to adopt a clear position concerning the poor performance of the supervisory boards of the educational institutions. Whilst stressing the importance of complaints procedures and the role of the Education Inspectorate, the Minister does not accept the recommendations made in this connection by the Education Council and



the Meijerink Committee.<sup>58</sup> Both the latter bodies recommend the establishment of an independent body that would be empowered to investigate complaints about the performance of a supervisory board, and form an opinion on the basis of this investigation. This would then be followed by some form of intervention, either by the organisation itself or by the minister. Both bodies feel that this regulatory authority could be made responsible for supervising all semi-public organisations that deliver services to the general public (such as housing corporations, hospitals and educational establishments). In the case of healthcare institutions, interested parties will be able in future to ask the Commercial Chamber to investigate supervisory boards whom they feel are not performing up to standard. The Court believes that a similar scheme should be set up for educational institutions.

Finally, the Court of Audit regrets that the ministers' response confines itself to educational and healthcare institutions, despite the fact that many other organisations are struggling with the same issues. The arguments, recommendations and checklist in this report apply far more widely than simply to the organisations that were the focus of the audit. They are also applicable to other institutions involved in public-private arrangements (such as the public broadcasting organisations, arts institutions and universities).

The Minister refers in her response to a memorandum she intends to send the House of Representatives and which will contain further details on her views regarding the use of public resources for investing in private-sector activities, and the way in which organisations report on such investments. A memorandum entitled *Verantwoording inzet publieke middelen* ('Accounting for the use of public funds') was presented to the House of Representatives on 20 July 2005.<sup>59</sup> The principles underlying the memorandum are broadly consistent with the Court's arguments and recommendations. On the basis of the findings of the present audit, the Court would like to make the following comments about the contents of the memorandum:

- The Court notes a lack of clarity in the way in which the various standards quoted in the memorandum are defined. The dividing line between what is and is not permitted remains open to

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<sup>58</sup> Education Council, *Degelijk onderwijsbestuur* ('Good governance in education', 2004, p. 49 and p. 67), and Meijerink Committee, *Educational governance bij BVE-instellingen* (2005, pp. 27-28). For a detailed discussion on the right of enquiry, see Social and Economic Council, *Ondernemerschap voor de publieke zaak* (2005, pp. 68-70).

<sup>59</sup> *Verantwoording inzet publieke middelen*: letter of 20 July 2005 from the State Secretary for Education, Culture and Science to the House of Representatives, ref. HO/CBV/05/22162.



interpretation (this applies, for example, to the criterion defined as 'establishing social ties and creating a climate that is conducive to study'). As long as the requirements remain so vague, it is not clear which activities are permitted and which are not. Apart from creating uncertainty for the organisations concerned, this also makes it difficult for regulatory bodies such as the Ministry's Audit Department and the Education Inspectorate to know which standards to base their opinions on. The 'Public-Private Platform', the formation of which is envisaged in the memorandum, could help to clarify the standards on the basis of specific cases.

- The memorandum entitled *Verantwoording inzet publieke middelen* ('Accounting for the use of public funds') prohibits organisations from distorting competition by obliging them to take the full cost price as the minimum market price of products and services. However, there are various ways of interpreting the term 'full cost price', depending on how clients are charged for overhead expenses and how hourly fees are calculated. The Court wishes to stress that market definitions and competition rules are important factors in deciding the conditions under which a public-sector organisation can operate on the commercial market. It would therefore be a good idea to provide scope in the standards for some form of input from both the Ministry of Economic Affairs (as part of its plans for introducing statutory rules for public bodies operating in the private sector) and the Dutch Competition Authority.



# Annexe 1

## Selection of sectors and cases

### Three sectors

The audit was restricted to three sectors in which public-private arrangements are used. The sectors selected for the audit reflect the wide variations in the nature and scale of public-private arrangements in practice.

#### *Adult and vocational education*

There are two reasons why this sector is relevant to the audit:

- on account of the commercial courses and in-company courses offered by the Regional Training Centres;
- on account of the fact that the Regional Training Centres are working more closely with private-sector firms in order to (a) offer sandwich courses as part of publicly funded courses, and (b) develop a joint training programme so as to strengthen the regional knowledge base.

The 2004 Budget published by the Ministry of Education, Culture and Science has the following to say about adult and vocational education:

'We need to encourage the formation of further links between organisations and private-sector firms, bearing in mind that ties with SMEs are particularly relevant to vocational education. One of the main objectives is for educational establishments to evolve into active members of the regional knowledge base with close links with trade and industry, the ultimate aim being to create new products and services.'

The Court's first audit report on legal persons with statutory tasks (2000) contained a section on financial management practices at Regional Training Centres,<sup>60</sup> one of the aspects of which was the separation of public and private resources. The audit showed that only half of all Regional Training Centres had proper accounting procedures for contract

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<sup>60</sup> *Verantwoording en toezicht bij rechtspersonen met een wettelijke taak* ('Accounting by and supervision of legal persons with statutory tasks'), House of Representatives, 1999-2000, 26 982, nos. 1-2.



activities, and that control measures related primarily to the quotation and planning stages, and not to the operational stage. Also, not all costs were included in the calculation of the full cost price and there was confusion as to exactly which activities were covered by the definition of contract activities.

#### *University medical centres (UMCs)*

The second sector covered by the audit is that of the university medical centres (UMCs). A university medical centre is a partnership between a university faculty of medicine and a university hospital. University hospitals have certain statutory tasks to perform in relation to patient care, teaching, research and the training of medical specialists.

All UMCs raise private sources of income. The grant received from the Ministry of Education, Culture and Science is referred to as the first source of funding. Payments received from external parties are referred to as the second, third and fourth sources of funding. The second source of funding comprises payments from organisations such as the Netherlands Organisation for Scientific Research (NWO) and the EU. The third source of funding is door-to-door collections, and includes payments from organisations such as the Queen Wilhelmina Foundation (the Netherlands Society for Cancer Relief), the Netherlands Heart Foundation and the Netherlands Kidney Foundation. The fourth source of funding consists of external clients, mainly private-sector firms. This means that UMCs are organisations that use public-private arrangements.

The Court also recognises outside activities performed by UMC staff as potentially constituting public-private arrangements. Outside activities may generate revenue, either public or private. If the staff of a UMC perform too many outside activities, this may undermine the standard of its public services. Outside activities also include work performed by staff for commercial firms and non-profit-making foundations that are not owned by the UMC in question, but with which the UMC has certain links. The assets owned by certain non-profit-making foundations may also be regarded as public resources. These two situations, involving a mixed public-private character and the associated risks, also occur at the UMC included in the audit.

Strictly speaking, support services provided at the UMC should also be classified as private-sector activities. These include the management of shop space, catering services and a multi-storey car park.



*Knowledge and innovation sector: TNO*

The government sees TNO and the leading institutes of technology as intermediaries that promote the exchange of ideas between organisations producing research data (i.e. the universities) and organisations putting such data to practical use, i.e. the demand from society. This intermediary role requires the leading institutes of technology to maintain close links with private-sector firms and civil society organisations on the one hand, and universities on the other. Organisations operating in the knowledge and innovation sector generally regard public-private arrangements as an indispensable means of transferring research findings to commercial and civil society organisations. There is a wide range of public-private arrangements in operation, involving central government, research institutes and private-sector firms. These include:

- *commercial activities undertaken by organisations with a public-sector task*, e.g. contract activities performed by universities and commercial research performed by TNO;
- the *co-funding* of research and development by private-sector firms and central government (in the form of grants from the Ministry of Economic Affairs and the Ministry of Education, Culture and Science);
- *public-private equity funds* for business start-ups in the technology or knowledge sectors (such as *Biopartner* and *Technopartner*);
- *public-private partnerships*: for example, the *Kenniswijk* experimental living environment in Eindhoven (ICT infrastructure);
- *public-private alliances and networks*, e.g. *Syntens*, a government-subsidised innovation network for businesses, advises small firms on innovation on behalf of the Ministry of Economic Affairs.



## Annexe 2

### Checklist for public-private arrangements

This checklist contains a list of points that need to be taken into consideration by organisations combining public tasks and public funding with private activities and private funding. You can use your answers to the following questions to quickly build up a picture of the current situation in relation to certain vital aspects of public-private arrangements.

#### Public-private arrangements

- Do you have a clear picture of the government regulations on public-private arrangements?
- Does your management board have a clear strategy for public-private arrangements? Is this strategy reflected by your organisation's mission and long-term plans?
- Does the management board have sufficient means of intervening in good time, should this be required in the light of the risks or if the arrangements in question do not generate the projected level of revenue?

#### Operational management

- Can you demonstrate that you are not distorting competition or making use of cross-subsidisation?
- Are you subject to the Dutch Competitive Trading Act and the EU Transparency Directive?
  - May your organisation, or certain parts of it, be regarded as constituting an 'undertaking' as defined by the Dutch Competitive Trading Act? If so,
  - Is it an undertaking with exclusive or special rights? If so,
  - Are you legally obliged to keep separate accounts of public-sector and private-sector activities?



- Does your system of operational management comply with the following requirements:
  - *Project management*: orderly and auditable?
  - *System of cost allocation*: full and clear (have the accounting policies been defined?)
  - *Accounting procedures*: are these in place, and if so, are they observed?
  - *Ethical standards and outside activities*: are there guidelines? If so, are they observed?
- Risk management: are you aware of the relevant risks? How are they controlled?

### **Added value**

- Are you able to prove that any public-private arrangements generate added value by raising the standard of your public services, or by generating financial benefits, changing the corporate culture or producing societal added value?
- Are 'public spirit' and the 'spirit of enterprise' both sufficiently prevalent among your organisation's staff?
- How do you demonstrate the added value of public-private arrangements to:
  - the supervisory board;
  - the minister;
  - your customers;
  - society at large?

### **Internal reports and supervision**

- Does the supervisory board (or the Audit Committee) have access to information on the revenue generated by, the risks associated with and the risk management pursued in relation to public-private arrangements, and is it able to instruct the management board to change its policy should it believe this to be necessary?
- Do the systems of internal control offer sufficient guarantees that full information is available on public-private arrangements, and that the risks associated with such arrangements are effectively managed?



### **External reports**

- Do the annual reports published by your organisation contain information on:
  - the reasons for entering into public-private arrangements;
  - the risks associated with public-private arrangements and the way in which these are controlled;
  - the actual results generated by public-private arrangements as compared with the desired results (in terms of innovation, quality, etc.) and your organisation's mission or long-term objectives?
- Can all the relevant stakeholders use your annual reports to form a picture of the nature, scale, associated risks and benefits of public-private arrangements?
- Are there other quality tools (such as peer reviews and benchmarking studies), in addition to your annual reports, that you use to assess and anchor the standard of your public services? Do you report on the results of such reviews and studies?

### **Internal supervision**

- Are the duties of the supervisory board clearly laid down in the law? Are details of its role given in other documents, such as a quality manual?
- Does the supervisory board have a framework that it can use to assess public-private arrangements?
- Is the supervisory board informed both fully and in good time about the risks associated with, the risk management pursued in relation to and the added value generated by public-private arrangements?
- Is the supervisory board able to intervene (for example, by withholding its approval) if it feels that this is necessary?



## Annexe 3

### **Conclusions, recommendations, responses and Court of Audit's afterword**

Conclusions  
Court of Audit's recommendations  
Responses of ministers and organisations  
Court of Audit's afterword

Whilst the organisations under review are given a certain degree of freedom with which to operate on a commercial basis, it is not always clear what sort of results this freedom is intended to produce and what the added value of their activities should be. For this reason, it is sometimes difficult to identify the object of public-private arrangements and to measure the extent to which they contribute in practice to the attainment of the organisation's objectives.

#### **1. Develop a clear legal framework for public entrepreneurship: provide clear guidelines about the opportunities and objectives**

The Court of Audit recommends the minister to develop a clear legal *framework establishing the principles of public entrepreneurship* and to provide the clearest possible guidelines, for those sectors encouraged to adopt public entrepreneurship, about the conditions applying to public entrepreneurship (i.e. the scope) and its ultimate objectives. The framework for public entrepreneurship should allow some scope for diversity in implementation.

The ROC MN would like to see the sector itself developing a framework along these lines in consultation with the minister, and would like to see more uniformity in the various guidelines.

The Minister of Education, Culture and Science believes that the planned statutory rules for public bodies operating in the private sector should provide a framework and that further information on scope and objectives should be provided in sector-specific guidelines. The 2005 'Clarity' memoranda on educational funding will be extended to include detailed guidelines on public-private arrangements. The Healthcare Charges Board



has adopted a policy on supplementary sources of income for healthcare institutions.

The Court endorses the ROC MN's call for greater uniformity in the guidelines. The Court stresses that the arguments, recommendations and checklist in this report apply far more widely than simply to the organisations mentioned in the minister's response.

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The supervisory mechanisms used by institutions of adult and vocational education and the UMCs do not generate a great deal of information on the effects of public-private arrangements on the standard of public services, or on the ability of the organisations concerned to achieve their policy objectives. At TNO, public-private arrangements are developed as part of the public-sector task on which the organisation is required to report to the minister.

**2. The minister and the supervisory authorities should focus more on public-private arrangements**

External supervisory bodies do not display a great deal of interest in the contributions made by public-private arrangements to the performance of the organisations in question, the risks entailed by public-private arrangements in relation to public funds and public services and in relation to the way in which they are managed by the organisations concerned. The annual reports should contain relevant information on the above points.

The ROC MN points to the increasing pressure that is being brought to bear on the supervisory chain and argues for standardised reporting documents and a comprehensive supervisory framework.

The Minister of Education, Culture and Science believes that the government's prime interest lies in delivering public services. Private-sector tasks may be performed alongside these public services, provided that the former do not impede the latter and provided that public funds are used in accordance with the rules set out in *Verantwoording inzet publieke middelen* ('Accounting for the use of public funds'). The 'Clarity' memoranda on educational funding will be adjusted: organisations will be required to include in their financial statements relevant information on



the added value generated by public-private arrangements and the risks potentially associated with them.

The Court has identified two risks in the principles underlying the supervisory mechanism for public-private arrangements which the Ministry of Education, Culture and Science wishes to put in place. These risks concern the vagueness of the requirements and the lack of clarity in the definitions used to prevent organisations from distorting competition.

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The statutory basis underlying the supervisory boards was inadequate in all three organisations under review. Supervisory boards are not supplied with information relating specifically to public-private arrangements as such. At the same time, the three supervisory boards under review do discuss matters that have a bearing on such arrangements.

**3. Supervisory boards should be given statutory status in order to provide a firmer basis for integrated supervision**

The supervisory board is the only body that is capable of overseeing all public-sector and private-sector activities and forming a judgement on the policy and business-related factors taken into account by the management.

Because of the vital role played by supervisory boards in the supervisory chain, the Court of Audit urges the government to give them a firm statutory status and also to provide for situations in which a supervisory board fails to perform adequately.

TNO shares the Court's view that the status of its supervisory board has not been clearly defined. In December 2005, TNO's supervisory board will present the Minister of Education, Culture and Science with a proposal for clarifying its status, tasks and powers. The supervisory board will incorporate the Court's suggestion that the Minister should make better use of the results of internal supervision for the purpose of exercising her external supervision.

In a memorandum entitled *Governance in het onderwijs* ('Governance in education'), the government announced its plans for making supervisory boards obligatory for institutions of higher, adult and vocational education. The status of the supervisory boards of healthcare institutions is one of the subjects covered by the draft implementation decree for the



Healthcare Institutions (Accreditation) Act. The Minister of Education, Culture and Science has stated that the issue of the boards' legal status is a topic of ongoing debate.

The Court of Audit points out that the education minister has failed to adopt a clear position concerning the poor performance of supervisory boards.

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Recently published industry codes suggest that a broad consensus is now emerging on a number of basic requirements, such as the need to avoid unfair competition and conflicts of interest, to provide clear information on business risks and to clarify the role and duties of supervisory boards, the external auditors and the audit committee.

Most codes of conduct pay very little attention to the specific requirements that public-private arrangements and public entrepreneurship entail for internal and external governance. For example, the codes have very little to say about operational management and reporting on added value.

**4. Industry codes should include provisions on operational management and added value**

The industry codes of conduct could be extended to include provisions on an orderly and transparent form of operational management, as well as provisions calling upon organisations to provide full information on the risks, the way in which these are controlled and on the added value, both planned and actual, of entrepreneurship in general and of public-private arrangements in particular.

The Minister of Education, Culture and Science wants the industry representative bodies to decide for themselves whether their industry codes should be extended or amended. The Minister of Health, Welfare and Sport recently received a copy of a code of conduct for the healthcare sector, including guidelines regarding the supervisory board's responsibility for an internal risk control system.

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Whilst both the government and the organisations under review expect contract activities to generate considerable added value, there are very few hard figures available on the degree to which and the way in which public-private arrangements help to raise the standard of public service or make any other vital and valuable contribution towards the future viability of the organisation in question. There is scope for improving both the management of and the transfer of intellectual property in the organisations under review.

There is room for improvement in the auditability and transparency of the factors taken into account by the management in weighing up the public interest and the organisation's statutory task against the interests of the organisation itself and its stakeholders.

**5. Organisations should publish information setting out their views on public entrepreneurship**

The Court suggests that public entrepreneurs should be obliged to draw up a document setting out their long-term plans and including revenue and cost projections, a risk analysis and an explanation of the risk-control measures taken in relation to public-private arrangements. The document should also explain the link between public-private arrangements and the public-sector task performed by the organisation in question. This information should make it easier for internal and external supervisory bodies to judge whether the organisation concerned has achieved its objectives and managed its risks.

The management board of the ROC MN and the Minister of Education, Culture and Science accept this recommendation.

TNO intends to increase its added value and make it easier for others to see. An improvement programme has been drawn up to this end, and has been discussed with the Minister of Education, Culture and Science.

The Minister of Education, Culture and Science is not ready to oblige the organisations to publish a document setting out their long-term plans, as she believes it forms part of a transparent system of reporting and feels it is now up to the supervisory boards to take the next step.

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Clear information is available on the amount of public and private funding received by the organisations under review. Information is also made available on the way in which these resources are spent. However, there is room for improvement and a greater degree of transparency in aspects such as the way in which the cost price is calculated, the attribution of costs and the breakdown of the price that is charged to customers. None of the organisations under review has a clear idea of the actual number of hours spent on the various activities. This means that it is not always possible to see from the records kept whether there has been any form of cross-subsidisation.

**6. Public enterprises should be required to invest in a transparent, orderly and auditable system of operational management that complies with EU legislation**

It should be clear what private funding is supporting the implementation of public tasks and, vice versa, what public resources are being used to support private activities. Guarantees relating to conflicts of interest and outside activities, as well as accounting procedures and measures relating to the organisational structure, can also help to enhance ethical standards and boost transparency.

The ROC MN accepts this recommendation and refers to various process improvement projects it has set in motion.

TNO believes that the operational management pursued in relation to patents, licences and privatisations is up to standard. Nonetheless, it would like to see the general guidelines and rules applying to public-sector and private-sector organisations in a process of privatisation fleshed out in more detail. In addition, it intends to undertake a critical analysis of its licence management procedures.

The Minister of Education, Culture and Science accepts this recommendation. The Healthcare Institutions (Accreditation) Bill contains a number of transparency requirements.

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Most internal reports concern the nature and scale of public-private arrangements and their financial results. Information on the degree to which public-private arrangements help the organisation in question to achieve its mission or strategic objectives is not provided as a routine aspect of the internal reporting cycle.



All the annual reports examined by the auditors complied with the statutory requirements relating to the aspects under review. Although the organisations do provide some information on their public-private arrangements in their published annual reports, the amount of information and the level of detail vary widely.

The information published in the annual reports of the organisations under review is not sufficient to justify any conclusion as to whether their public-private arrangements contribute to a beneficial cross-fertilisation between their public and private activities. Their annual financial statements and annual reports proved to contain very little explicit information about the potential added value of public-private arrangements and the way in which the pertinent risks are controlled.

## **7. Reporting on public-private arrangements should be improved**

In order to increase the potential for benchmarking – and hence the learning opportunities – the Court of Audit recommends that annual reports should contain more, and more systematic, information on the nature, scale, benefits (both projected and actual) of and the risks associated with public-private arrangements. More information should also be provided on how such arrangements benefit public services.

The Court of Audit recommends that organisations should ensure that the reports they publish define the relationship between their public task, mission, long-term objectives (i.e. strategy), annual targets and the extent to which public-private arrangements contribute to the achievement of these aims. The Minister could issue guidelines in this connection, in consultation with industry representative bodies.

The management board of the ROC MN endorses this recommendation and would like clear information on the long-term aspects of public-private arrangements to be included in both the organisation's stated policies and the report of the management board included in the ROC MN's annual report.

In accordance with the Court's recommendations, TNO's annual reports will contain clearer information on its added value to society.

The Minister of Education, Culture and Science refers to the document entitled *Verantwoording inzet publieke middelen* ('Accounting for the use



of public funds'), which lists the points on which the organisations are required to report, including their public and private activities and the associated financial flows. She does not wish to lay down any rules for benchmarking studies. The regulations on annual reports published by healthcare institutions encourage the latter to report on their activities to the outside world.

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### **8. A checklist for public-private arrangements**

The Court of Audit has devised a checklist that institutions can use to gain a quick impression of their own performance in a number of important areas relating to public-private arrangements.

The Minister of Education, Culture and Science feels that the Court's checklist for public-private arrangements is a good idea, providing as it does a set of practical guidelines.