

Horizons

KPMG CZECH REPUBLIC

Public Administration
and the Private Sector

Activity Based Costing:
A New Perspective on
Public Expenditures

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Public Administration

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“Join us in looking beyond the limits of typical advisory services and become familiar with modern approaches to solving your business problems.”

A handwritten signature in white ink, appearing to read 'Dostálek', positioned above the printed name.

František Dostálek
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Editorial

Eva Racková
Partner
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“The Czech Republic currently draws significantly less money from European Union funds than it could.”



Public Administration in the European Union

The Czech Republic currently draws significantly less money from European Union funds than it could. One of the reasons for this is that project financing has not yet become a fully accepted part of the budgetary process in the public sector. There are still marked differences between public sector entities concerning the efficiency of their internal processes, the level of partnership and the ability to create and implement a development strategy. When it comes to selecting projects for EU financing, apart from the substance of the project, these are the decisive selection criteria and not simply the institutional and financial stability of the public entity.

The Czech Republic has recently been criticised for its low drawings from European Union funds. According to some data, it is next to last of all EU countries, just ahead of Greece, however, the underlying numbers do not fully reflect funds that have been allocated but are not yet being drawn (i.e. those projects that have not yet been completed). The money is "in the pipeline", as subsidies are paid retrospectively, upon completion of a project or completion of a specific stage of a project.

Nevertheless, the fact remains that the Czech Republic is drawing significantly less than it could. The main reasons for this situation are the complex administration related to the drawing process, both in the EU and in the Czech Republic, the lower degree of project management and financing and

the lower efficiency of entities in the public sector compared with those in the private sector.

The problem can be traced back to the changes in the area of financing after 1990. The private sector benefited from the creation of a market economy and has adapted to the alternative forms of financing relatively quickly, however the public sector has encountered significant difficulties in adapting to multi-source financing. This process lasted a long time and remains in some areas today. As a result, project financing has not yet become a fully accepted part of the budgetary process and this is related to the low drawing of structural funds from the EU. Project financing and the possibility to draw from EU structural funds nevertheless provide great opportunities for further development, expansion and the deepening of activities in the public sector.

In terms of increasing the capacity for drawing funds for development projects, two aspects are key – the substance of the projects and the ability to maintain their results in the long term.

In public administration it is therefore necessary to look at other topics, such as public support, public and private partnerships, questions about absorption capacity, benchmarking, new views of budgeting, etc. All of these will lead to more effective processes in the area of public administration, increase the ability to select and draft worthy projects, to implement them and to successfully ensure that their results are maintained in the long term. Public administration

entities are stable from an institutional and financial point of view, but there are marked differences between them in terms of the efficiency of their internal processes, the level of partnership with entities in the private and non-profit sector, the ability to create and implement a development strategy and to link short, medium and long-term budgets and financial plans to one overall plan.

Apart from the substance of a project, these are the decisive selection criteria when selecting projects for EU financing and not simply the institutional and financial stability of the public entity. When identifying weaknesses in the functioning of an organisation, the benchmarking method can be used, which may encourage the organisation to adopt good practice from tried and tested procedures used by other similar entities and which can be applied to improve the efficiency of the organisation's own internal procedures.

The substance of a project is no less important. In this issue of Horizons we offer, for example, some inspiration for the use of brownfield sites for tourism purposes. In almost every municipality it is possible to find unused land, derelict factories and farm buildings, non-functional military space and unused cultural centres or department stores from the socialist era. If we look at the high potential for tourism in the Czech Republic, the solution to the problem of "what to do with these buildings and this land" seems obvious.



Public Administration and the Private Sector

Czech accession to the European Union and the adoption of the Union's legislative and institutional environment have resulted in new challenges and opportunities, both in the private sector and in the area of public administration. In the latter case, these mainly relate to strengthening of internal management and control of expenditure. However, due to the narrow intellectual base and the lack of dialogue between the public and private sectors, it is difficult to create consistent and transparent internal management and control procedures. Until now, public administration has not taken sufficient advantage of tried-and-tested working procedures in relation to management, monitoring, reporting, auditing and evaluation.



“The competitiveness of public administration is helped by partnership with the non-profit and private sectors, supported by EU intervention programmes and international co-operation.”

Following Czech accession to the European Union and adoption of its legislative and institutional environment, public administration and the private sector face new challenges and stimuli. Managers in the private sector, where the transformation has been completed very successfully, and managers in public administration, who are still not fully involved in the decision making process, have a common task – to strengthen competitiveness, which in practice means modernising internal management and improving control over spending processes.

Public administration and private sector managers have an objective need to measure the value they get from the money they use, both inside and outside an organisation. However, this is never an easy task. An organisation creates value internally by increasing the quality of its management and control of its internal processes and externally through its activities.

It is also necessary to consider how value is divided into added value and public value. Generally, added value is easily measurable, for example in monetary terms. Public value is less easily measurable but should also result in economic or other benefits. Added value for a company is reflected in the profit after tax compared with the previous year. Public value for a ministry is, for example, the effect of passing a new act.

Public Administration

We understand public administration to be the administration of public matters in the public interest by central government and local authority bodies. After the reform of local authorities, the Czech Republic was divided into thirteen independent regions, the Capital City of Prague and almost 6,300 independent municipalities, of which 205 perform public administration using independent and transferred powers.

The Czech Republic has adopted a local authority financing model whereby certain decisions are made by the local authority based on its autonomous powers and other decisions are made based on powers delegated by the state. Within this model, increased transparency is required in respect of the internal management and control processes.

Public administration finds itself under pressure due to its own lack of competitiveness. Ministries reflect competitiveness principles in programmes co-financed from EU funds, but they do not fully appreciate the need to reduce the competitive deficit, for example by permanently anchoring the function of manager in their organisational structures, strengthening management and controlling public spending and the role of internal audits, introducing audit committees and establishing a position of general internal auditor for the public sector.



The competitiveness of public administration is helped by partnership with the non-profit and private sectors, supported by EU intervention programmes and international co-operation. For example, common investment activities using leveraging to obtain the necessary financial resources for investment of a public nature from the private sector.

Private Sector

The private sector in the Czech Republic has successfully adapted to the competitive environment of a global economy and is contributing to the creation of good practice in the management and control of internal processes. On a European and global scale, however, it still has some way to go and is assisted by a range of EU programmes.

What we primarily lack is the necessary experience and financial means for investing in the modernisation of managerial skills and the related ICT applications, which enable the opportunities created by the new technology to be adapted to the current organisational structures and human resources of a specific organisation.

“The global standard is key for the creation of international standards and the transfer of good practice. The Czech Republic is a member of OECD and is able to apply trends in standards in its legislation and the institutional structures of public administration. It can also learn from the errors of other organisations. However, it is not taking full advantage of these conditions, which is probably related to the absence of a sufficiently wide intellectual base and the lack of dialogue between the public and private sectors on this topic.”

At the current time there is talk about investment in intangible assets, for example in society’s intellectual capital. Discipline and structured work processes are given priority where each entity, person, team, company department or business knows the budget and what is expected of them, what added value they create and what public value is generated.

More and more often in recent years there has been discussion about the role of large corporations and their attempt to concentrate and strengthen their power. This requires well thought-out forms of financial and legal engineering, the implementation of logical processes that improve the transparency of internal management and control processes, strengthen productivity and support growth in added value. Holding company organisations are often mentioned in this context.

A holding arrangement enables management decisions to be taken independently of shareholder policy. Another advantage is that the holding organisation does not have a special legal form, it can be a company of legal entities, a trading company or a capital company. The new generation of holding companies are an example of modern methods of getting key persons into the management of a company thereby increasing the quality of intellectual capital.

Holding companies are characterised by the aforementioned leveraging. Internal management and control tools are created to deal with receivables, payables and the risks associated with various financial, capital and other operations. As Professor Claude Champaud defined it in 1962, “A holding company is a method of financially and structurally organising groups of companies that enables the

easy control of the companies' assets and efficient and consistent economic management and control."¹

Main Problems of Public Administration

The main problems of public administration in the Czech Republic exist at three levels that are related to the strengthening of internal management and control of expenditure. The first level is global, the second two relate to the problems of public administration at a European level and inside the country, regions and municipalities.

The global standard is key for the creation of international standards and the transfer of good practice. The Czech Republic is a member of OECD and is able to apply trends in standards in its legislation and the institutional structures of public administration. It can also learn from the errors of other organisations. However, it is not taking full advantage of these conditions, which is probably related to the absence of a sufficiently wide intellectual base and the lack of dialogue between the public and private sectors on this topic.

At a European Union level it is necessary to highlight the initiative of the European Commission which, ten years ago, during the early stages of countries' preparations to join the EU, started to support the transparency and harmonisation of internal management and control processes in public sector bodies and organisations through the PIFC (Public Internal Financial Control) system. The concept for the introduction of the PIFC system exists in the Czech Republic, but has not yet gained the necessary penetration.²

There are also specific internal problems, which are illustrated by the following two examples. The first concerns the modernisation of state administration where the position of the financial manager, for example in the areas of budgeting, financing, reporting and accounting, is still not clear. This is not because it is difficult to understand the new working procedures, but because it is still not fully understood that the aforementioned managerial methods are not only necessary to prepare the Czech Republic for drawing from EU funds, but need to be permanently embedded in all areas of public administration.

The second example is related to modernisation of local authority administration. Regions want to enhance their ability to absorb the funds allocated for their structural intervention operational programmes for 2007–13. An amendment to the relevant act has been passed and specifies Regional Councils for Regional Cohesion. There is a certain parallel even for co-operation between municipalities. A legal analysis by the Ministry of the Interior referred to the need for legislation in favour of the establishment of Associations of Municipalities as legal entities, the same as in the case of Regional Councils. In both cases, however, there is a risk that unless there is close coordination with state administration bodies during the modernisation of public spending processes, problems may arise.



Conclusion

The aim of this article is to provide some examples of how good practice can be transferred between public administration and the private sector. Such co-operation could be put at risk if the central bodies of the Czech Republic continue to support the dual-tracking of internal management and control systems, i.e. if they support their application when using EU funds, but separately implement national, regional and local subsidy programmes where EU funding is not involved. In terms of the gradual improvement of the public spending processes in the Czech Republic, however, there are certain optimistic expectations that are again based on the European Commission's initiative. In its communication Strategic General Principles of the Community for 2007–13 the EU calls on all member states to modernise their public administration activities.



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¹ Alain Couret, Didier Martin, *Holding Companies*, Publishing House HZ, 1997, p. 7.

² Zdeněk Chaluš, *Reform of Public Administration and the PIFC System*, Horizons, May 2005: http://www.kpmg.cz/czech/images/but/Horizons_May_2005.pdf

Activity Based Costing: A New Perspective on Public Expenditures

Public sector management is not driven by the need to create profit; however, this does not mean that public services cannot be provided in an efficient way. In order to better understand how the available resources are used, we need to identify the true cost of the various activities performed. One of the methods that private entities often use in this regard is the Activity Based Costing (ABC) method, which is based on the assumption that it is difficult to manage something that cannot be quantified and objectively measured. Its application in the public sector represents a major step towards an efficient and accountable public service, managed on the basis of real and measurable costs of its operations.





Since 1989, the Czech Republic has witnessed increasing demands on the quality of public administration and the efficient use of public funds. Relations between the state and its citizens are no longer defined in terms of power and control, but rather in terms of service. In this regard, public administration operates as an intermediary that re-distributes taxes collected from the people and returns them in the form of services provided. The major issues include the levels of efficiency and transparency in the way public funds are consumed and the extent and quality of services received by citizens in return for their taxes.

Private and Public Sectors

Public sector activities lack one of the key incentives that drive business operations in the private sphere – the creation of profit. To achieve this aim, private entities continuously improve their management systems, optimize their processes, apply new methods of budgeting and financial planning, risk management, etc.

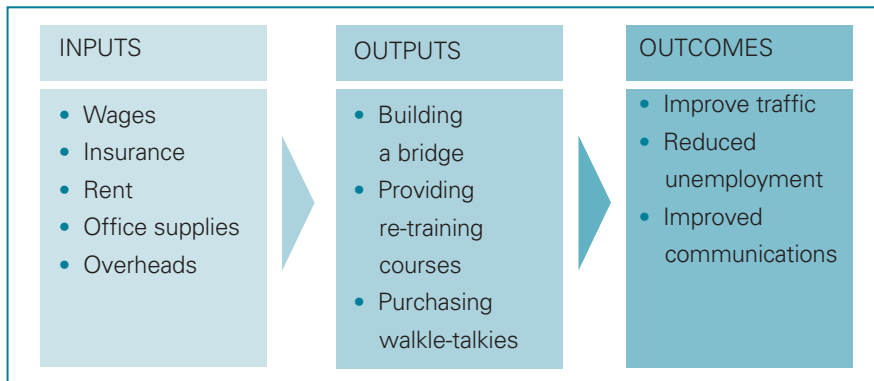
The main objective of public institutions, on the other hand, is not to make a profit, but to provide public goods and services. These are not usually offered by private entities on the free market as they are consumed collectively and it is difficult to provide for their exclusive use and therefore set a unit price for individuals. The market fails. Services of this type include, for example, street lighting, public parks, roads and national defense.

Since the public sector lacks a natural incentive to improve its efficiency, it usually lags behind the private sphere in adopting new approaches and methodologies in practice. In some cases, however, it can take inspiration from methods that have succeeded in the private sector.

“ABC is a supplementary budgeting method that measures the pattern of consumption of the organization’s resources by the various activities performed.”

Inputs, Outputs and Outcomes

When analyzing public services, it is important to differentiate between inputs, outputs and outcomes. The picture below depicts the mutual relations between the three categories:



Monitoring systems in the public sector are usually not designed to measure outputs and outcomes, nor to establish links between them. Fulfilling a given task or producing a certain output is usually perceived as the end goal, rather than the means to achieve the ultimate outcome. However, taking the above picture as an example, the main aim should not be to measure the number of re-trained unemployed people, but rather the number of people, who, after taking a re-training course, manage to find a new job and hold it for more than one year. If none of the people who take a re-training course are able to find work, or if all of the re-trained course graduates are once again unemployed after one year, then perhaps there is something wrong with the courses. Their administration may be very efficient, with low costs and high numbers of graduates, but they are ineffective and unable to attain the main goal for which they were originally created: to reduce unemployment. At the end of the day, the time and funds invested in the re-training courses are wasted. Similar reasoning can be applied to almost all activities performed or financed from public funds, e.g. waste collection, road maintenance, fire protection, or processing applications for ID cards and building permits.

Activity Based Costing (ABC): Basic Principles

In many cases, the revenues of public agencies are not set up in a way that offsets their costs. Such practice defines successful financial

management as containing expenditure within the approved budget. It does not focus on analyzing the activities performed and finding ways to improve or link the organization's costs to its goals. The fact that the same amount of money could produce better results is often ignored. As a result, financial monitoring and control in the public sector tends to concentrate on the cost of resources rather than the activities and services that these resources produce. ABC helps to revise traditional budgetary models so that they provide more meaningful performance indicators and data on meeting the stated objectives.

ABC is a supplementary budgeting method that measures the pattern of consumption of the organization's resources by the various activities performed. In other words, ABC breaks down all direct and indirect costs and assigns them proportionally to all of the organization's activities and their outcomes, regardless of functional or organizational unit.

If, for example, an office worker spends an average of 40% of his or her total time on administering re-training courses, then 40% of the total cost of employing that office worker (e.g. wages, health insurance,

fringe benefits etc.) will be allocated to re-training courses. This amount will be included in the costs that have to be incurred in order to provide re-training courses, which may include, for example, wages and benefits for course instructors, classroom rental, insurance, office supplies, overheads, etc. As a final result, the organization's line-item budget is converted to a performance-based budget, as shown in the example of a generic unemployment office (see table on the next page):

From a methodological point of view, ABC defines all activities, their final outputs, main goals, financial demands and performance indicators. The performance-based budget allocates the costs and resources to the final outputs (services), rather than simply itemizing the initial inputs (resources). The information obtained can then be used to assess the efficiency of all activities performed and their capacity to deliver the organization's main goals and objectives, which can be integrated into the budget for the following period. In practice, ABC needs to answer the following questions:

1) What are we doing? (definition of an activity)

Example: We provide re-training courses for the unemployed.

2) What do we define as a unit of output? (identification of a unit of output)

Example: One re-trained unemployed person.

3) Why are we doing it? (reasons for performing the activity)

Example: To reduce unemployment.

4) For whom are we doing it?

(identification of recipients of the final output)

Example: For the unemployed, society.

5) How much does it cost us? (taken from the performance-based budget)

Example: \$2 million per year.

LINE-ITEM BUDGET		PERFORMANCE-BASED BUDGET	
• Wages	3 227 000	• Receipt of applications	1 685 000
• Payments	826 000	• Payment of benefits	1 591 000
• Insurance	1 754 000	• Issue of permits	397 000
• Rent	78 000	• Database of job seekers	824 000
• Depreciation	491 000	• Database of job vacancies	793 000
• Office supplies	1 603 000	• Re-training courses	2 000 000
• Overheads	968 000	• Other	1 792 000
• Other	135 000		
Total	9 082 000	Total	9 082 000

6) What is the overall output?

(identification of the number of units of output)

Example: 200 re-trained unemployed people per year.

7) How efficient are we? (identification of the cost per unit of output)

Example: \$2 million/200 = \$10,000 per re-trained person.

8) How effective are we? (proposed quantification of service quality)

Example: 25% – 50 re-trained people found a new job and held it for more than one year.

9) What should we do about it?

Is 25% enough? What is our goal? Why did 150 people fail to find a new job? What do we have to change about our courses? Are we teaching them the right things?

Example: 25% is not enough. Our goal is 75%. People can't find work perhaps because our courses don't add any value for employers. We should make our courses more responsive to the labor market.

The above example shows that the unemployment office wasted \$1.5 million re-training people who failed to find new work. Another important piece of information is the calculation of the costs associated with re-training one unemployed person. In this case it is \$10,000. If the office re-trains only 150 people next year, it will save about \$0.5 million. Conversely, if it plans to re-train 300 people, it will need \$1 million more.

However, one of the most valuable benefits for management purposes tends to be the breakdown of the total costs per activity into individual cost items. The office managers may discover, for example, that office supplies and overheads represent 30% of the total cost of re-training courses. Why is that the case? Is it too little or too much?

Implications for the Public Sector

The greatest benefit of ABC is information. Identification of the true costs of all activities enables inefficiencies to be identified and facilitates better management based on objective, measurable and controllable factors.

The public sector abounds with opportunities for using ABC. Setting the level of administrative charges, such as the fees for a new ID card, passport or building permit, would be much more realistic if the actual personnel, administrative and overhead costs were properly identified and documented.

ABC can also be useful in meeting the regulatory requirements related to the transparent use of public funds. This is particularly important for institutions that carry out business activities in addition to subsidized public duties, as a result of which they must maintain separate accounting records and be able to document the actual costs associated with all provided services. Examples include publicly funded organizations, research institutes, postal services providers, etc.

Last but not least, ABC can be a very effective tool for comparing selected cost and service indicators of subsidiary organizations that perform identical activities in different regions, divisions or offices (benchmarking). Identifying regional and/or functional differences and their causes can help the central management to understand which activities/divisions add value to the customer and which do not, and to focus on those areas that need improvement.

Conclusion

The initial reason for using ABC may be to reduce costs and optimize financial management, reflecting the true costs of operation. The main benefit of ABC, however, is not simply the precise recognition of costs associated with the activities performed, but its capacity to increase accountability by providing information that helps to assess service quality and to improve budgeting and financial planning based on objective data.



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Benchmarking in Public Administration

Benchmarking is a widely used instrument for comparing the performance of entities in the public and private sector. The application of benchmarking and the resulting outputs stimulate the entities being compared to look for ways to enhance the quality of their internal control and management processes and to achieve better results.



“Although benchmarking is not unknown in the Czech Republic and such activities do take place in public administration, their practical importance and impact on the modernization of public administration remain underestimated.”

The essence of benchmarking consists of comparing entities with the aim of finding the best of the best and passing its qualities on to the others. An entity can also be benchmarked against a relative or absolute standard built on good practice, with the aim of achieving this standard in its control and management systems.

Benchmarking supports the creation of standards wherever this is desirable. A case in point is the reform of public administration in the United Kingdom, during which the results were benchmarked, agreements on public services monitored and set objectives and their fulfilment compared. Benchmarking thus helps to raise the quality of internal processes in public administration, leading to a higher quality of projects and services (see the Internet pages of Local Government Performance, <http://www.bvpi.gov.uk>).

Although benchmarking is not unknown in the Czech Republic and such activities do take place in public administration, their practical importance and impact on the modernization of public administration remain underestimated.

For example, state, region or municipal bodies can use benchmarking in their administrative structure to facilitate implementation of the processes necessary to meet the European Guidelines for Implementation of the INTOSAI Auditing Standards.¹

Benchmarking can be a useful tool for employee training and for enhancing the processes related to the purchase of services, goods, and construction work in accordance with these standards.

Administrative and absorption capacity of local authorities

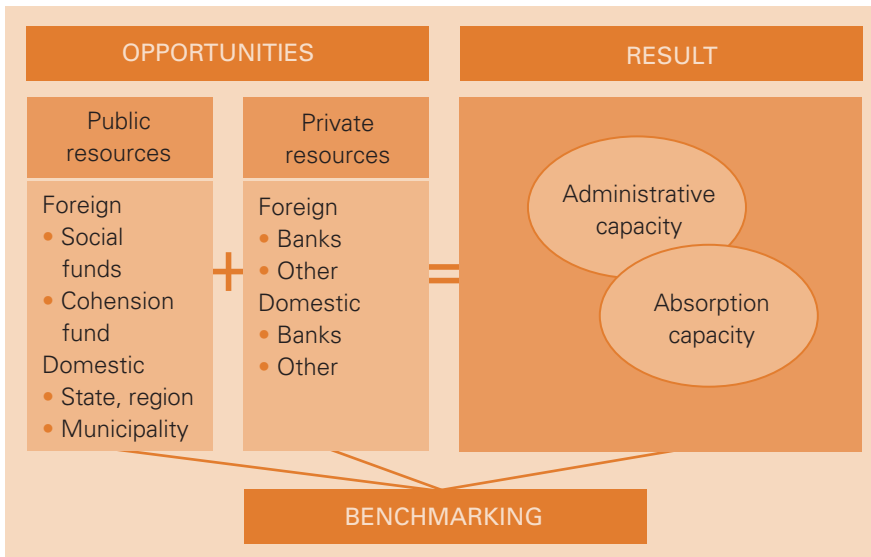
Benchmarking can be used to prepare local authorities for structural interventions in the period 2007–13. The first step is to form a clear idea of what we expect from benchmarking. Then we choose suitable indicators to be compared, analyze their underlying criteria and look for ways to improve them.

In the case of structural interventions it is useful to monitor two factors – administrative capacity and absorption capacity. Administrative capacity is a view of the internal and external institutional and legislative framework that determines the local authority’s actions and the scope for further improvement.

By absorption capacity we mean specific inputs that the local authority must incorporate into its administrative procedures in order to achieve the required objectives. In the area of structural interventions, municipal and regional councils must absorb as much of the funding allocated through the Operational Programmes as possible. The absorption process has to respect the conditions laid down by EU law.

¹ INTOSAI, International Organization of Supreme Audit Institutions





Practical application of benchmarking

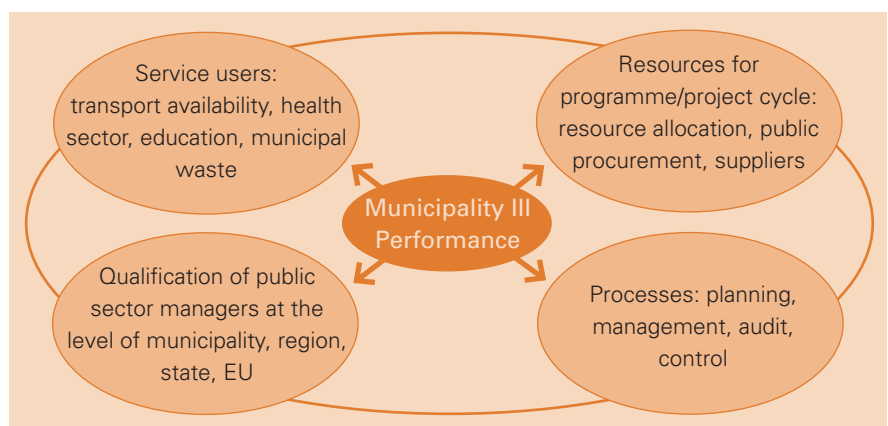
Last year, together with the Department of Regional Development of the Ústí nad Labem region, we launched the project ‘Benchmarking municipalities of the 3rd type in the Ústí nad Labem region with respect to the use of EU funds’. Its aim was to provide the municipalities concerned with qualified recommendations in respect of their further development of activities using EU funds.

We collected the input data by means of a questionnaire and semi-structured interviews with representatives of the municipalities concerned. We then analysed the results to produce an overview of the information ascertained, which we used to formulate recommendations for improving administrative and absorption capacity.

Subsequent to the analysis and based on our recommendations, we devised a project co-financed from EU funds which should help to raise the quality of administrative capacity and to ensure sufficient absorption capacity for municipalities of the 3rd type in the Ústí nad Labem region.

In deciding on recommendations concerning administrative capacity we employed the balanced scorecard (BS) 1st generation method, which is focused on the following categories: customer, finance, processes and know-how.

We divided the information from the questionnaires and the interviews into these categories and proposed recommendations for resolving the issues in each one. The links between the categories for municipalities of the 3rd type are shown in the diagram below.



With regard to absorption capacity we used the benchmarking methodology adopted by the European Commission to gauge the effectiveness of the Structural Funds’ administration (e.g. as used in the project “The

Effectiveness of Methods for drawing from Structural Funds in EU Member States”). This methodology, developed by the Italian institute ISFOL (Istituto per la Formazione dei Lavoratori) was originally used to benchmark the European Social Fund, but was later also extended to other Structural Funds.

This methodology compares seven key factors that affect absorption capacity:

1. Costs of implementation
2. Programming
3. Managerial structures
4. Project selection
5. Implementation structures
6. Monitoring and evaluation
7. Financial management

As with the results for administrative capacity, we divided the information into the above categories and proposed recommendations for each of the issues identified.

Project outputs

With regard to administrative capacity, our results showed that the municipalities concerned clearly prefer investment (hard) projects that help

them to resolve their local problems without considering the wider context. Partnership between municipalities resulting in joint procedures and joint regional strategies (e.g. in micro-regions) is not widely exploited and is



severely underestimated. Moreover, if a partnership does exist, it frequently does not produce any additional benefits. It would be therefore useful to create documentation that sets out the advantages of such partnerships in a way that is clear and understandable.

A weakness exists in the area of strategic studies and financial planning. These two management instruments are applied by municipalities on an ad-hoc basis with no shared methodology. Apart from zoning plans there is no joint development policy from the level of municipalities of the 3rd type to municipalities of a lower level. Despite this deficiency the municipalities being monitored succeed in keeping the debt service indicator within reasonable limits. In this sense municipalities have created relatively good conditions for credit activities in the next intervention period.

We reviewed the absorption capacity of the participating municipalities in terms of the project cycle. One area for further improvement concerns standardized programming processes tied to the seven key factors mentioned above, such as developing a more financial – analytical approach.

This finding relates to the robustness of managerial structures in the area of public administration. The analysis showed that municipalities of the 3rd type do not work completely in conformity with internationally recognized standards and have no instruments to regulate and standardize their managerial processes. Municipalities also lack consensus about the roles of the financial manager (and managers in general) and the internal auditor in public administration.

Conclusion

The project 'Benchmarking municipalities of the 3rd type in the Ústí nad Labem region with respect to the use of European Union funds' shows how the benchmarking and balanced scorecard (BS) methods can be applied to projects in public administration related to administrative and absorption capacity. The number of issues that we mapped in the project is much higher than we can outline here, however, for all of the relevant categories, we provided qualified recommendations for further action to develop activities using European Union funds.



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Brownfields: An Opportunity in the Tourist Sector?

A photograph of a golfer in a blue shirt swinging a club on a green field. A golf ball is captured in mid-air above the golfer's head. The background shows a blurred landscape with trees and a path.

The importance of tourism is growing in the Czech Republic. Its further promotion in the regions depends to a large extent on the infrastructure, which is frequently underdeveloped. A possible solution exists in renovation and adaptation of areas and facilities previously used for industrial, agricultural or military purposes – otherwise known as brownfield sites.

“Brownfield sites that are not so well located or are too large or too small for standard commercial development projects can be used to develop tourism. The Czech Republic already has good experience of using brownfield sites in this way.”

In quantitative terms, tourism has been on the increase in the Czech Republic, perhaps with the exception of a short period after the terrorist attacks in 2001 and just after the floods in 2002. The share of this sector in the GDP is ca 12 percent and the number of jobs created by tourism is approximately 600,000, almost 14 percent of the sum total in the country. The extent to which the sector’s potential in the Czech Republic has been realised can be seen by comparison with average employment rates in the other European Union countries, where according to some sources, tourism accounts for up to 20 percent of jobs. The potential in the Czech Republic is estimated to be up to 22 percent.

Central administration bodies and the authorities responsible for tourism are lulled into inaction by the already positive development of this sector and do not create the necessary conditions to drive further development and to raise standards in the area of tourism. On the other hand, government agencies and councils at a regional level have begun to realize the potential benefits of developing tourism.

Brownfield sites

As previously mentioned, the development of tourism in a given region is closely related to the standard of the surrounding infrastructure. Where the infrastructure is underdeveloped, one of the options

that can be considered is the development of existing brownfield sites.

According to the definition provided in a study by Jiřina Bergatt Jackson, brownfield sites are urban, abandoned or under-used properties whose development may, but need not necessarily be, prevented by environmental contamination. They are areas that are losing, or have already lost, their original function but the complexity of their future development discourages private and other capital intervention.¹ They are normally found in urban areas, in the centre or on the outskirts of cities, and cover a large area, usually more than two hectares. Brownfield sites may be abandoned industrial facilities or rural areas damaged by mining but also include abandoned army bases, farming facilities (dairy farms, haylofts, silos), as well as commercial, cultural and social centres, in the form of gigantic concrete constructions built during the socialist era. Today, some of them serve as no more than a restaurant as the municipalities have been unable to find any meaningful use for them.

If the redevelopment of a site is prevented by past industrial or farming activities, it is unlikely to be suitable for similar activities in the future. Prospective investors are not sufficiently interested in developing such sites. Provided there is no ecological threat, for example pollution

¹ Jiřina Bergatt Jackson et al, *User-friendly Brownfields, Handbook Mainly for Staff of Municipal Councils*, IURS – Institute for Sustainable Urban Form, 2004, <http://www.brownfields.cz/publikace/Brownfields.pdf>



of water sources, the situation is not likely to change in the future.

Compared with towns in Western Europe, Czech and Moravian towns have a remarkably high percentage of industrial zones (on average, 25–35 percent compared with 10–15 percent). Industrial zones were often developed in and around urban centres as there was no free market to regulate industrial development in these localities through higher prices for land. In the market economy many industrial companies reduced their production or were wound up and the disused land became a brownfield site. The same happened to real estate owned by the Czech army, Czech Railways, or by the agricultural sector.

Use of brownfield sites in industry and in towns

It is relatively easy to find a use for extensive abandoned industrial facilities or military bases. Their location, size, connection to municipal networks and transport infrastructure allows their

further use in industrial production, logistics, or as technological parks. There are also many options for similarly classified areas in bigger towns. Whether they are on the outskirts or in the centre, they can be used to implement various commercial projects. Light industrial production, logistics, office projects, shopping centres, as well as residential projects, can be found not only in Prague, Brno or Ostrava (for example, Karlín, Smíčov, Vysočany in Prague or Vaňkovka in Brno), but also in smaller towns, where their potential motivates investors to invest in regeneration projects.

Use of brownfield sites in the development of tourism

Brownfield sites that are not so well located or are too large or too small for standard commercial development projects can be used to develop tourism. The Czech Republic already has good experience of using brownfield sites in this way.

Golf facilities

The Sokolov Golf Club project, which is now nearing completion, represents one of the first examples of how spoil banks can be regenerated for the benefit of leisure and tourism. The extensive grounds covering an area of some two hundred hectares contain an eighteen-hole golf course of an international standard, with support facilities for the players and visitors. There is a club house with a restaurant, bar, VIP salon, and summer terrace, with a total seating capacity of two hundred and car parking for one hundred passenger cars. For visitors' recreation there will be a zoo park and a forest park. This was a project carried out by Sokolovská uhelná as part of the regeneration of the former lignite mines.

In the area of golf tourism in this region, the increase in the number of high quality golf courses and availability of first-class accommodation, catering facilities and wellness services may help to turn this region into a destination for international golf tourism.



Water features

The reduction in coal mining in the Sokolov region made it necessary to refill abandoned mines and in some cases, owing to a deficit of landfill, flooding was chosen as the method of regeneration. This creates another great opportunity for the revitalization of brownfield sites and development of tourism in a region, which, with the exception of the spa localities in Karlovy Vary, has suffered from extensive industrial development and has never been a traditional tourist destination.

This is not such a new idea. Since the end of the 1950s regeneration in the Sokolov region totals 2,444 hectares, including 29 hectares now under water. Further regeneration covering 983 hectares began in 2000, with farming and forestry predominating. Following the phasing out of mining in the Sokolov coalfields, more than 1,800 additional hectares are to be transformed into water features.

Farming

The phasing out of farming production created a problem in many places as to what to do with the abandoned former collective farms and state farms, which, despite the efforts of the local municipalities, have not been revitalised. Although in some places, small-scale production activities have been installed (such as a joiner's workshop), the facilities are generally underused.

Almost without exception, the regions suffer from insufficient capacity and quality of tourist support facilities (catering, accommodation and other services). Unused farming facilities, in particular farm buildings on historical estates, if they have survived in satisfactory condition after years of

exploitation by state and collective farms, could meet this need. Their character, picturesque location and historic value create a perfect atmosphere if a suitable investor can be found to finance their restoration and conversion into a tourist facility. These buildings provide an ideal opportunity to create facilities with sufficient capacity to ensure their cost-effective operation.

The feasibility of such schemes is confirmed by projects already implemented in the farm buildings of a number of Czech manors (Hluboká, Kynžvart, Valtice). There are plans to use some of these facilities for recreation and sports, for example as a golf course.

Conclusion

A number of firms are showing increased interest in revitalization or regeneration of brownfield sites, their decontamination and subsequent development and use. Doubtless there is also the motivational effect of financial support from the government and the relevant EU bodies in the form of various subsidies. There are many interesting possibilities for the use of any specific brownfield site in developing the infrastructure for tourism. The key moment will come when these firms realize that this is the best way to develop brownfield sites and merits the same support as the other forms of development mentioned earlier.



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VAT and Municipalities



The new VAT Act provides local government with new opportunities to optimise their cash flows. Registration for value added tax can bring benefits to the municipalities through optimisation of their cash flows, possible increases in net income, or changes in the timing of cash-flows from investment projects that have a relatively long-term return on investment.

“One of the main benefits of registration for value added tax is that a municipality is able to optimize its cash-flows from investment projects that have a relatively long-term return on investment.”

Passed in connection with the accession of the Czech Republic to the European Union and harmonisation of Czech law with EU law, the new VAT Act provides municipalities with new opportunities to optimise their cash flows. On the other hand, the financial managers of municipalities who tried to meet the demands of the new VAT Act or to take advantage of the opportunities provided by it were sometimes frustrated by the initial ambiguity, the lack of any interpretation by the Ministry of Finance and the lack of practical experience of the municipal councils.

In general, financial managers of municipalities associate registration for value added tax with increased administrative duties, increased supervision by the tax authorities and uncertainty about whether the transactions of the municipality are compliant with the current VAT Act. For this reason most municipalities have attempted until now to avoid registration for value added tax in different ways. In the two years that have passed since the effective date of the new VAT Act, only a small percentage of municipalities were obliged to register or decided to register voluntarily.

In some cases registration for value added tax can bring benefits to municipalities through optimisation of their cash flows. In the first place, municipalities can raise their net revenues while preserving or reducing the prices charged to end customers for the services provided to them. One of the main benefits of registration for value added tax is that a municipality is able to optimize its cash-flows from investment projects that have a relatively long-term return on investment.

To pay or not to pay VAT – example of capital investment

The differences between municipalities registered and those not registered for value added tax in respect of long-term investment projects can be illustrated with this example. A municipality plans to build a house of culture. Once it is finished, the municipality lets the house to an operator for rent which covers the costs of its operation. Let us suppose the total cost of construction of the building amounts to 10 million crowns, excluding VAT.

If the municipality is not registered for value added tax, it cannot exercise any claim to deduct value added tax in the construction of the building. Value added tax will be part of the acquisition cost of the building, which would in this case amount to 11.9 million crowns. This sum becomes the municipality's cost through depreciation of the property. The subsequent lease of the building to the operator would not be subject to VAT, but in the calculation of the rent, the municipality would take into account the amount of depreciation of the leased building.

If the municipality registers for value added tax and lets the building to an operator also registered for value added tax, it can claim deduction of value added tax for goods and services purchased during the construction. The acquisition cost of the building would then be 10 million crowns. By registering for value added tax the municipality would achieve an immediate saving in cash-flow in the amount of 1.9 million crowns.

VAT-registered customers of municipalities

To estimate the total savings it is necessary to take into account the amount of future rent and the lessee's right to claim deduction of value added tax from the billed rent. For major investment projects with a long-term return on investment, the savings in cash-flow are always high.

In other cases, registration of a municipality for value added tax must be viewed individually depending on the specific circumstances, in particular the nature of the activities carried on. In respect of any activities that constitute taxable supplies, it is necessary to consider the rate of value added tax applicable to the supplies,

the tax rate applicable to goods and services purchased by the municipality to make such supplies, and the tax status of the customers that purchase the respective goods or services from the municipality.

Generally speaking, VAT registration is beneficial if the typical customer is also registered for VAT and can deduct VAT on supplies made. This can be demonstrated by the following general example involving one activity.

1) Municipality not registered for value added tax

	Sum excluding VAT	VAT (19%)
Purchased inputs	5,000	950
Added value	1,500	-
Price for end customer	7,450	-

The price for the end customer consists of the price of the purchased inputs, including value added tax, and the margin of the municipality, which covers internal costs and profit.

If a municipality is not registered for value added tax, it cannot claim deduction of VAT on the input for purchased goods and services, and the total price for the customer is 7,450 crowns. The price in this case is the same for a customer registered for value added tax and a non-registered customer. In this case, not even a registered customer can deduct value added tax.

If a municipality is registered for value added tax, it can deduct VAT on the purchased goods and services and the total price for the customer is 7,735 crowns. But if the customer is registered for value added tax, it can deduct value added tax on purchased services or goods. The value of this supply is then only 6,500 crowns.

In comparison with the first situation the effective price is reduced for a customer registered for value added

tax by 950 crowns. This difference allows the municipality to adjust the price and hence increase its net income.

It is often argued that the typical customer of a municipality is not registered for value added tax, most of its customers being citizens or inhabitants of the municipality who are not registered for value added tax. In this case the price is higher by 285 crowns. To assess the situation in the municipality one should consider that the activities carried out by municipalities for their inhabitants as part of public administration are always out of scope of the regime of

2) Municipality registered for value added tax

	Sum excluding VAT	VAT (19%)
Purchased inputs	5,000	950
Added value	1,500	-
Price for end customer	6,500	1,235

value added tax, even if a municipality registers for value added tax. It does not impose tax on these activities and the municipality may not deduct value added tax for supplies purchased for purpose of these activities. In respect of these activities it always applies the regime described in the first situation.

Pitfalls of registration for value added tax

Registration of a municipality for value added tax is not advantageous in all cases. If a municipality registers for value added tax, it pays value added tax for all activities which are not within the sphere of public administration and not only for those activities in respect of which registration is advantageous to the municipality. It is also necessary to consider whether the increased administrative demands connected with VAT registration, such as completion of VAT returns, keeping VAT records and records of taxable supplies received, keeping records of

supplies to calculate VAT deductions on the input, or issuing tax invoices for taxable supplies will not outweigh the positive benefits of registration.

In conclusion, registration of a municipality for value added tax should always be preceded by a detailed and thorough analysis of all aspects of registration. One should consider not only the existing activities carried out by a municipality, but also the activities that it expects

to carry on in the future. It is therefore necessary to consider the benefits of registration in the medium term. Cancellation of registration, if it is shown to be disadvantageous for a municipality, can be a lengthy process, involving much administrative work and can take more than a year to finalise.

A possible solution for some projects prepared by a municipality can be to spin off the activity to an independent VAT registered entity set up by the municipality. This solution can partly remove the administrative burden on the municipality in the area of value added tax.

“In conclusion, registration of a municipality for value added tax should always be preceded by a detailed and thorough analysis of all aspects of registration.”



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Public Support and EU Funds

In connection with the European Union's attempt to increase its competitiveness in the world economy, the importance of protecting the economy from activities that interfere with free market principles is increasing. The provision of public support is one of these activities. If it is not implemented in accordance with set rules, it could interfere with market mechanisms and damage business between European Union member states. If correctly targeted, which should apply in the case of structural intervention from EU funds, public support should contribute to economic development.

In the period before accession to the EU, the Czech Republic's Office for the Protection of Competition (the "Office") was authorised to monitor the public support that the Czech Republic undertook to implement in the European Agreement. The basis for the supervision was the Public Support Act, No. 59/2000 Coll. The Czech Republic's accession to the EU enabled community law on public support to be applied directly and used immediately. The power to decide on the admissibility of public support has been transferred directly to the European Commission (EC) and the Office was given the role of a central consulting, coordinating and advisory body. Alterations to the method of assessing and checking public support also resulted in legislative amendments and the Public Support Act was replaced with effect from 1 May 2004 by the Act on Amendment of Some Relations Regarding Public Support, No. 215/2004 Coll. Since its accession to the EU, the Czech Republic has had to comply with the rules on public support contained in primary and secondary EU legislation.

Legislative Framework

The basic provisions governing public support are contained in Articles 87 to 89 of the Treaty Establishing the European Economic Community. The first section of Article 87 contains a general prohibition against the provision of public support. Support

may be regarded as public support and therefore prohibited as such, if it has the following characteristics:

- it is provided by a member state or a broker appointed by a member state out of government or other public funds
- it interferes with or threatens to interfere with economic competition
- it provides certain companies or certain production sectors with an advantage that they would not obtain under ordinary market conditions
- it damages trade between member states.

The second section of Article 87 contains an enumerative definition of three types of support that are exempted from the general prohibition. They can be defined as assistance of a social character, assistance for the repair of damage caused by extraordinary events and assistance for certain areas of the Federal Republic of Germany affected by the division of Germany.

In addition to the aforementioned automatic exemptions from public support, the third section of Article 87 defines support that can be regarded as compatible with the common market of the Community.



This concerns:

- support that should help the economic development of an area with an extraordinarily low standard of living or with high unemployment
- support that should help the implementation of a project of common European interest or remedy a serious defect in the economy of a member state
- support that should facilitate the development of certain economic activities or areas, unless the terms of trade alter to such an extent that they are in conflict with the common interest
- support to develop and maintain cultural heritage, if it does not affect the terms of trade and competition in the Community to a degree conflicting with the common interest
- other types of support that could be defined in a decision of the Council adopted by a qualified majority following a proposal made by the EC.

Block Exemptions

For the purpose of simplifying the process of granting and approving public support, the EC accepted block exemptions, in the form of several

regulations. If the conditions set out in these regulations are met, it is possible to provide public support to small and medium-size enterprises as well as support to increase employment and to develop education and training. In addition to the three block exemptions, a regulation on de minimis support was approved. The de minimis rule states that the amount of support granted to one enterprise may not exceed EUR 100,000 in the last three years. A draft amendment to the regulation proposes increasing the limit to EUR 150,000. All regulations on block exemptions, including the de minimis regulation, are valid until the end of 2006, i.e. new programmes co-financed from EU funds in 2007-13 will be approved in accordance with new rules.

Guidelines and Communications of the European Commission

In addition to implemented regulations, the EC also deals with the rules for public support in the form of guidelines and communications, in which it defines its approach to assessing certain types of horizontal, sector and regional support. Regional support is provided for the development of less developed regions and comes in the form of support for investment and the creation of new employment opportunities. The EC presents the rules and criteria for this type of support in the draft guidelines for national regional support for 2007-13 ("the Guidelines"). The Guidelines define the territorial scope of support which, in the case of the new member states, is the same as the area included in the objectives of the EU Convergence Policy for Economic and Social Cohesion. The Guidelines include rules for providing investment and operational support, including defining eligible expenditure and rules for accumulating support. They also contain the principles for drafting a map of regional support that defines the intensity of public support for

the various regions. Provisions on assessing support for large investment projects are newly integrated into the Guidelines. Until now, this support was assessed in accordance with an EC communication, the multi-sector framework for regional support of large investment projects.

Approval and Checks

The procedural rules for the approval and control of the provision of public support are laid down in EC regulations. With the exception of support in accordance with the de minimis rules and support covered by block exemptions, the support regimes have to be notified to the European Commission. After receiving them, the European Commission promptly starts the notification procedure – the preliminary assessment stage, which will conclude with one of the following decisions:

- the notified measure does not constitute support
- the notified measure constitutes support, but the Commission finds that there are no doubts about its compatibility with the principles of the common market ("decision not to raise objections")
- if the Commission ascertains that there are doubts about the compatibility of the notified measure with the principles of the common market, it will adopt a "decision to initiate the formal investigation procedure".

Formal Investigation

For the purpose of a formal investigation it is necessary to arrange a comprehensive assessment of the case in question through further investigation of the disputed matters together with the relevant member state and ascertaining the opinions of the interested parties. The Commission can conclude a formal investigation by adopting one of the following decisions:

- it is not public support – this is the case if the Commission ascertains that, after the appropriate alterations by the relevant member state, the notified measure does not constitute public support
- positive decision – this is the case if the Commission ascertains that the doubts arising from the preliminary assessment of the compatibility of the notified measure with the principles of the common market are removed by suitable alterations being made by the relevant member state and the Commission decides that the support is compatible with the principles of the common market
- conditional decision – the Commission may supplement a positive decision with conditions under which support can be regarded as compatible with the principles of the common market and stipulate duties that enable monitoring of whether the relevant conditions are fulfilled
- negative decision – the Commission may conclude that the notified measure is not compatible with the principles of the common market and will not be implemented.

In the case of block exemptions, member states are only under a duty to inform the European Commission of the start of a new regime for support within 20 days of the regime's implementation. If public support is provided in conflict with EC rules and is therefore prohibited public support, a member state is under a duty to recover such support from the recipient, including the interest stipulated in accordance with EU rules. The Commission's power to require support to be returned is time-barred after 10 years.

Conclusion

The rules for public support apply to all entities engaged in economic activity, i.e. public and private enterprises, including non-profit organisations, if they are engaged in economic activity, and to all types of public expenditure. They therefore also apply to support provided from EU funds. The duty to comply with the rules for public support is set for EU funds directly in the draft regulation on general provisions concerning the European Fund for Regional Development, the European Social Fund and the Cohesion Fund. Programmes co-financed by EU funds which meet the criteria for public support must therefore be notified to the European Commission and approved by it (except block and de minimis exemptions). The provider is responsible for notifying support, i.e. in the case of EU funds, the relevant managing authority is responsible and must identify the parts of a programme constituting public support and apply the proper exemption from public support to them. When implementing a programme, it is the duty of

the managing authority to ensure that the support provided does not exceed the framework for which it was approved by the EC. The managing authority is also responsible, possibly by the delegation of certain duties, for monitoring the use of public support and for reporting to the Office for the Protection of Competition and to the European Commission. Although ensuring that the provided public support complies with EU rules is the duty of the provider, the recipient of the support must also know the conditions for the specific support scheme as a part of which it is implementing the project, so that it is not exposed to the risk that it will have to return the support received. In this connection it is necessary to retain all documentation related to a project for the required period. If the recipient of support has doubts about its compliance with EU rules and the conditions for the scheme, the relevant bodies should be contacted to obtain clarification.

“If correctly targeted, which should apply in the case of structural intervention from EU funds, public support should contribute to economic development.”



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Structural interventions in the programming period 2007–13

As a new Member State of the European Union the Czech Republic was able to draw on the Structural Funds (SF) and the Cohesion Fund (CF) for the first time during the shortened programming period 2004–06. In the forthcoming regular programming period 2007–13 it will be able to draw many times more from these funds than in the previous period.



Our country has around fifteen years' experience of using various financial instruments and EU aid programmes. Like the other candidate countries we tapped pre-accession development aid through the PHARE, ISPA and SAPARD programmes. Since our accession to the EU two years ago we have been able to draw funds from the SF and CF.

The last period provided an opportunity to learn about the use of EU development programmes and to prepare for the next programming period, which will bring about many changes. It will be the first intervention period in which we will be able to participate for all seven years. In view of the expected development of macroeconomic indicators in the Czech economy it is also expected to be the last period, which highlights the need to make full use of the funds being offered. There will be far-reaching changes in the system and the rules for implementing programmes co-financed from EU funds, reflecting the European Commission's emphasis on decentralization of aid management to the national level of each Member State. However, the main and most remarkable change will be a ten-fold increase in the amount we are able to draw from the EU funds.

Financial perspective for the period 2007–13

Approval of the financial perspective for the period 2007–13 was a defining moment for the EU policy of economic and social cohesion (ESC). The Union will manage a budget of 862.4bn euros in this period, of which 307.6bn euros will be earmarked for the ESC policy. Of this, approximately 26.7bn euros (ca 773.9bn crowns) will be allocated to the Czech Republic. The following table, containing the allocations from EU funds and the commensurate co-financing from Czech sources, shows that in comparison with the current

“As the next programming period is approaching, potential applicants for aid from EU funds should begin preparing their projects.”

shortened period, when we received approximately 2.6bn euros (ca 76.1bn crowns), this represents an almost four-fold increase in the annual average.

Distribution of funds between resources and objectives (billions of CZK, current prices)

Objective resource	2004–06	Avg./year	2007–13	Avg./year
Convergence	91,5	30,5	883,0	126,1
EU (SF+FS)	70,3	23,4	750,6	107,2
Czech Republic	21,2	7,1	132,4	18,9
Regional Competitiveness & Employment	7,6	2,5	14,3	2,0
EU (SF)	3,8	1,3	12,2	1,7
Czech Republic	3,8	1,3	2,1	0,3
European Territorial Cooperation	2,7	0,9	13,1	1,9
EU (SF)	2,0	0,7	11,1	1,6
Czech Republic	0,7	0,2	2,0	0,3
Total	101,8	34,0	910,4	130,1
EU Total	76,1	25,4	773,9	110,6
Czech Republic Total	25,7	8,6	136,5	19,5

Source: Ministry for Regional Development of the Czech Republic

Most of the funds will be channelled to the territory identified in the Convergence objectives, which is the whole of the Czech Republic apart from the capital, Prague. Approximately eighty percent of EU funds will come from the European Regional Development Fund (ERDF) and the CF, which are intended to finance investment projects. According to the approved National Development Plan, the main emphasis is placed on investment in the development of transport and environmental infrastructure at a national and regional level, with considerable funding to be allocated to the development of entrepreneurship, research, innovation and tourism. There will also be a sizeable increase in the resources allocated from the European Social Fund (ESF), which are earmarked for “soft”, non-investment projects in education and support for employment.

Changes in the management of the SF and the CF

According to the draft EU law, there will be far-reaching changes in the method

of managing the SF and the CF, the most important being:

- articulation of three new objectives of ESC policy: Convergence, Regional

Competitiveness and Employment and European Territorial Cooperation

- a new approach to aid management with more decentralization to the level of Member States
- an increase in the maximum share of co-financing from EU funds to 85 percent for all funds and aid objectives
- application of the rate of co-financing to total eligible costs, from public and private resources, which should help reduce the pressure for co-financing from Czech public resources
- introduction of the n+3 rule for allocations for the period 2007–13, which should contribute to increased use of allocations for the first half of structural interventions
- introduction of mono-funding operational programmes, which should help simplify their management and increase transparency
- changes to the general rules of the European Commission relating to the eligibility of costs with more detailed regulation within the competence of the Member States

- the possibility to use EU funds in some new areas.

New Regional Operational Programmes (ROPs) will be implemented, which will replace the existing Joint Regional Operational Programme. The ROPs will be managed by the regions within each of the cohesion regions at the level of NUTS II (Nomenclature of Units for Territorial Statistics). Thus the regions will be able to focus the EU funds on those areas that they consider are most in need of subsidies for further development.

Project preparation

As the next programming period is approaching, potential applicants for aid from EU funds should begin preparing their projects. The competent bodies have already called for preparation of major projects, demanding considerable investment projects which should be financed from the CF. Timely preparation of projects is essential for drawing successfully on resources, from both the CF and from the SF. Municipal bodies should create a pipeline of quality projects that they can smoothly transform into project applications for a subsidy from a suitable operational programme. They should interlink strategic development plans and the possibilities of co-financing such projects from funds offered by the EU.

It is expected that in the period 2007–13 the municipalities and the regions will demand significant funds for investment in the transport sector. In addition to construction and modernization of road and rail networks, which will attract funding from the CF, there will also be investment in public transport in urban centres which will be financed by the ERDF. In this area KPMG Czech Republic has already prepared two projects in the current period for municipal clients, to modernize and expand public transport and to construct electricity lines for more environmentally friendly transport.

Time schedule

The starting point when preparing a project application for a subsidy from EU funds is to check within which operational programme, with what priority and within which area of support the project can be implemented, whether sufficient funds are available and what the conditions are for acceptance, evaluation and approval of projects. If, after carrying out this initial research, an applicant decides to prepare a project, he should then consider the wider aspects. It is essential to draw up a time schedule for the preparation process, to analyse all requirements of the project, and to carry out an assessment of alternative methods of financing. Of equal importance is the need for the applicant to estimate his own abilities and capacity to prepare the project. Here it is necessary to consider the alternative of using an advisory firm, which is more likely to have the specific skills, knowledge and experience to provide a full service to the applicant in drafting the project application.

When preparing a project application it is necessary to fulfil all of the formal requirements and to ensure that the proposed project meets all of the necessary assessment criteria. In terms of the formal requirements, it is necessary to properly complete the application form and to supply all of the required additional documentation. The core of the project preparation is usually a feasibility study (FS) and, depending on the extent of the project, a Cost-Benefit Analysis (CBA). These studies should clearly prove the feasibility of the project, its positive outputs, benefits, and sustainability.

Feasibility study

A key document in any project application is a feasibility study which considers all aspects of the project. This study should contain a detailed description of the project content,

technical specification, time schedule and the structure of its management. It also formulates the marketing strategy and mix and assesses the project's environmental impact. In the financial part of the FS it is necessary to project the cash flow of the project and analyze the break-even point and other indicators, such as the net current value of the project, the internal rate of return, and the payback period. The FS also includes a sensitivity analysis and a risk management analysis.

A Cost-benefit analysis, which should describe in detail the financial and economic rating of a project, is normally required for all major projects. Projects run by public entities are for the most part non-profit and their financial rating is frequently negative. What is often decisive are the overall socio-economic benefits of such projects and the benefits to the environment and quality of life. The results of the CBA are then used to produce the financial part of the FS.

These activities are necessary in the pre-investment phase of every project. If a project is approved, the investment phase with all related activities then follows, such as implementation, management, financing, control and monitoring. This is followed by the operating phase during which the demands relating to sustainability of the project results must be met. Finally, a project enters the post-operating (liquidation) phase, during which the project outputs are liquidated or modernized at the end of their useful life.

Conclusion

The next seven-year programming period is now just around the corner. Work will culminate in the Czech Republic this year on drafting the programme documents, implementation structures and the rules and procedures for drawing funds from the SF and CF, which are expected to be simplified. Potential applicants for such subsidies, from both the public and the private sector, should gradually start to prepare their projects, or modify those projects that did not succeed in the shortened period 2004–06 but might be successful in the conditions of the new period. A sufficiently strong pool of projects should be created, thereby creating conditions to maximise use of the SF and CF. A key group of beneficiaries of aid will again be represented by the regions and municipalities, which should integrate resources from EU funds to finance their development plans. Related to this development, documents are being drafted in the form of Regional Operational Programmes at the level of the NUTS II regions. However, it will be also important to consider the potential use of subsidies from EU funds in the development strategies of the municipalities.



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KPMG International is the coordinating entity for a global network of professional services firms, providing audit, tax, and advisory services, with an industry focus. The aim of KPMG member firms is to turn knowledge into value for the benefit of their clients, people, and the capital markets.

KPMG in the Czech Republic

KPMG has been active in the Czech Republic since 1990, when the first office in Prague was opened. At the present time, KPMG Czech Republic employs 580 people, with offices in Prague, Brno, České Budějovice and Jablonec nad Nisou. KPMG Czech Republic provides audit, tax services, risk advisory services and financial advisory services.

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