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**Dear reader!**

In 2006, the National Audit Office also worked to bring real benefit to the state by providing competent observations, opinions and recommendations. Taxpayers have the right to demand a lot from us. For the amount of money spent on the NAO's maintenance costs the taxpayers expect results that are worth the expenses.

In drawing up the 2006 work schedule thorough discussions were held with each department in order to filter out those possible audits that would be the most profitable for the state in the current year. Social expectations hold a high place among our many criteria. From these discussions I got the impression that several steps have been taken during the year to know the auditee, the people and policy as well as information acquired regarding the solutions provided for problems. We need to pay more attention to analytical work.



However, it is very clear that the steps taken so far are not enough. But I also realize that this base that needs years to develop cannot be created quickly. Many people in our building carried out their first, second or third audit in 2006. It is undoubtedly a trait characteristic of our organization, something that would be hard to understand anywhere else in the world. But this is our situation and therefore we have to work twice as hard.

Our resources are limited as is everything in our small country. Thus we have to focus on what is important instead of paying attention to many things at the same time. Concentrating on small things prevents us from focusing on big issues that are primary in the life of the state and that require hundreds of millions or even billions of kroons.

Generally we only look into the past when it helps to improve the process of making decisions regarding the future. Every audit must provide a possibility to draw conclusions regarding future behaviour. Then it has value and the money spent on this audit has been well spent.

I hope that this year we will be more able to rise above things and look at them as a whole.

Mihkel Oviir  
Auditor General

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# 1. The NAO's core activity in 2006

## **Who does the National Audit Office work for?**

The National Audit Office is an independent auditor that operates in the interests and on the account of taxpayers and has the task of looking into how the state and local governments have spent taxpayers' money and what they have offered in return. The results of the work of the NAO are first of all addressed to the Parliament, Government and the general public.

The NAO's relationships are maintained with the Government. While auditing a report, activity or key issue, we always treat it as "belonging" to someone, i.e. as a person's immediate obligation to take care and assume responsibility. Of course, the manager of the agency or entity being audited has the principal liability, but we have also emphasised the principle of the minister's liability for the area of government in question for several years. We deem it a natural and efficient way of solving problems by forwarding the majority of our suggestions to the topmost authority of an area of government who - even if not having a "personal relation" to the problem - bears the ultimate responsibility for what is going on in the area. At the disposal of a minister are the tools that enable systematic settlement of problems: a minister is able to not just finalise management-related nuances within an administrative agency, but refer problems to the Government in order to discuss them, to issue better orders and regulations that regulate the work of several agencies, and to initiate drafts of legislation.

While the National Audit Office and ministries act as discussion and debate partners, whose task is to see to it that the state manages the affairs of taxpayers as efficiently and economically as possible, the roles of the Parliament include both that of a designer of discussions and of an intermediary. On one hand, by issuing legislation the Parliament provides the framework discussions, on the other hand it evaluates, on the basis of the information submitted to it by the NAO, how in spending public money the Government has abided by the will of the people's representatives, i.e. laws. While doing that, the NAO is not only interested in the activity's official compliance with the legislation but also in whether the legislation and the activity of the Government is enough to ensure the expedient and purposeful use of the funds as well as reporting that would give an adequate overview of the expenses. Thus, the objective of communicating with the Parliament is to make recommendations on improving the management of the state (i.e. first and foremost the use of taxpayers' money). It is not in the competence of the NAO to punish anyone, nor does it exercise authority, by making recommendations the NAO helps those whose job is to adopt decisions.

Being based on audits carried out during a year, the NAO prepares a summary report that will be presented to the Parliament - an overview on the use and preservation of state assets during the preceding fiscal year. This is the NAO's constitutional duty.

In this chain of relations, the role of the taxpayer is certainly that of the owner - without the taxpayer there would be no money to spend, the spending could not be audited and neither the spending nor the auditing could be evaluated. Since irrespective of the issue under review the case always concerns the money of the taxpayer, i.e. the owner, the results of audits carried out by the NAO are brought to the general public via the Internet and media.

Both the Constitution and the State Audit Office Act declare that the NAO is an independent institution that is competent to decide on the manner, time and nature of its audits. Nonetheless we do not aim at independence to an extent where nothing actually depends on us. We are ready to consider the wishes of those for whom we work within the scope of the criteria that we have established for ourselves (the aim of carrying out audits the results of which could be universalised in broader terms as regards the entire government sector; the number of people whom the topic essentially affects; the amount of money). Generally the audit objects are determined as a result of monitoring. This means that information has to be collected systematically regarding the areas of life that the NAO is interested in, in order to get an overview of the problems and the steps the state has taken to solve

them. In addition to looking for new audit objects we also observe the course of things when already audited objects are concerned, considering a follow-up audit.

In the international usage, institutions like the NAO are referred to as “supreme audit institutions”, which means that they have a say in other supervisory activities of the public sector besides the principal activity, i.e. audits. Auditors of the NAO advise officials in the development of management, accounting, control systems and audits. The single aim is to ensure that as much taxpayer money as possible is controlled with as few expenses as possible.

### **Essence of financial audit**

The State Budget Act establishes the obligation of the National Audit Office to give an assessment to the report on the implementation of the state budget, drawn up by the Government of the Republic. Preparation of the opinion on said report has been the duty of the Financial Audit Department and in order to fulfil that duty we planned and performed financial audits in a way that they would cover major cash flow, assets and liabilities that are important from the state’s point of view. That meant performing financial audits in both the ministries and their sub-offices as well as in foundations founded by the state, companies with state participation, etc.

Upon performing its audits the NAO relies on the auditing standards of INTOSAI (International Organisation of Supreme Audit Institutions) according to which the financial audit consists of

- the audit of the annual accounts including an opinion on financial reports;
- the legality audit observing the legality of transactions, i.e. assessing the compliance with applicable law and regulations (compliance with requirements).

While auditing the annual accounts we wish to assure its reader that the annual accounts correctly record the activities of the reporting entity during the period as well as its financial conditions at the end of the period. Upon auditing the legality of transactions we assess whether the auditee in its economic activities has complied with the relevant legislation applied in its area of activity.

Without giving an opinion we shall also point out the observations on financial management and internal control systems made in the course of the audit.

### **Essence of performance audit**

The objective of the performance audit is to provide comprehensive information on the shortcomings of the activities of the public sector for the Parliament, Government and the public as well as to direct the responsible officials to eliminate said shortcomings. But the National Audit Office does not stop at identifying and characterizing the shortcomings, it also tries to analyze the reasons for the problems and suggest ideas for their elimination. Another objective of the performance audit is to identify the best administrative practice and contribute to their distribution.

The object of the performance audit and the monitoring activity the audit is based on include everyday problems and public sector’s activity in solving them. The NAO tries to focus on problems that will influence a lot of people over a long period of time, and regarding which there is reason to suspect systematic errors in the state’s activity. Avoiding getting caught in politics, the fact whether the Government has taken or planned to take any steps to solve the respective problem is also taken into account upon selecting objects for performance audit. Also, the audited problem may be one regarding which the Government does not have a specific plan of action but which is important for the achievement of a national objective specified on a more general level.

Performance audit focuses on three aspects – economy, efficiency and effectiveness.

**Economy** (minimizing the expenses made in order to achieve an objective) is generally not separately audited by the NAO but opinions on economy may be given when auditing efficiency.

In assessing **efficiency**, the NAO analyzes the processes administered by the public sector – if and how it would be possible to increase the profit of the activities by using the same resources, or reach the same goal by spending less.

In assessing **effectiveness**, the NAO analyzes the following:

- achievement of objectives declared in legislation and planning documents;
- actual effect achieved through the activity in comparison with desired effect (if there is no information regarding the effect or it is insufficient, the NAO itself will try to collect necessary information).

The NAO is also interested in the prerequisites of efficiency and effectiveness. This means that we analyze whether in planning and implementing activities the public sector takes guidance from the principle of sound administration and actual needs of society. Moreover, the NAO may also examine whether the Government has a purposeful plan of action to achieve certain social objectives, how it has developed, if and how it is connected to other activities of the Government and whether it is sufficiently managed. A lot of attention is paid to the existence and reliability of the reporting information characterizing expenditure, total net gain and effect.

## 1.1. Structure

In 2006 the structure of the National Audit Office was as follows:

**Audit Department I** audits the area of government of the Ministry of Finance, the Ministry of Foreign Affairs, the State Chancellery and constitutional institutions. Ines Metsalu, the Director of Audit of Department I accepted an apprenticeship at the European Court of Audit and her position was assumed by **Juhani Lemmik**.

**Audit Department II** audits the area of government of the Ministry of Justice, the Ministry of Defence and the Ministry of the Interior as well as county governments. **Ülle Madise** is the Director of Audit.

The duty of **Audit Department III** is to audit the area of government of the Ministry of Education and Research, the Ministry of Culture and the Ministry of Social Affairs. **Jüri Kõrge** is the Director of Audit.

The auditors of **Audit Department IV** are responsible for auditing the area of government of the Ministry of the Environment, the Ministry of Economic Affairs and Communications and the Ministry of Agriculture. In autumn, the Director of Audit, Olav Lüüs assumed the office of NAO Advisor – his work is continued by Director of Audit **Tarmo Olgo**.

**Audit Department V** works with local governments in order to contribute to the strengthening of control over the legitimacy of using public sector funds. **Krista Aas** is the Director of Audit.

## 1.2. Audit Department I

Audit Department I audits constitutional institutions (Office of the Chancellor of Justice, Office of the President, Chancellery of the Parliament, Bank of Estonia and Supreme Court), Ministry of Finance, Ministry of Foreign Affairs, State Chancellery as well as the state authorities and companies operating in their areas of government and areas of administration. The area of government of the Ministry of Finance comprises the Tax and Customs Board, Statistical Office and Public Procurement Office as well as AS Andmevara, AS Eesti Loto and Riigi Kinnisvara AS. The area of government of the State Chancellery comprises the National Archives.

There were 16 positions in the department, one director of audit, three audit managers, 5 senior auditors, 6 auditors and junior auditor. At the beginning of 2006, ten of these positions had been filled – the positions of a director of audit, two audit managers, two senior auditors and 5 auditors. During the year, three new people were employed by the department, one as the director of audit, one as audit manager and one for the position of auditor. A director of audit, one audit manager and one auditor left the department in 2006. The principal problem for the department in 2006 was the poor filling of positions and staff turnover.

In 2006, one of the objectives of the department was to improve the quality of auditing the consolidated annual report of the state and gather information on problems occurring upon using the EU support. In 2007, the work continues on reaching an agreement on the method and scope of the assessment of the consolidated annual report of the state and on the regularisation of necessary amendments. An overview of the use of the European Union's funds shall be submitted to the Parliament.

During the year, 10 audits were launched and 14 audits were completed with an audit report, including five of those that had started already in 2005. 10 of the completed audits were financial audits and 4 were performance audits. The preliminary analysis for one audit led to the decision that audit procedures are not necessary. Initially, in addition to audit procedures, a section was to be prepared for the overview on the use and preservation of state assets. Due to the scarcity of material, it was decided to include this section in the special report "Special report on the use of European Union financial support in Estonia 2004–2006".

In the past few years, the quality of accounting and financial reports has improved in the state. Here, the NAO contributes by annually drawing attention to shortcomings and making recommendations in an overview on the use and preservation of state assets as well as in the consolidated report of the NAO on the consolidated annual report of the state, also in the audits of annual reports of state accounting entities. The NAO shall continue to make efforts to complete the consolidated annual report of the state earlier, by 31 March. This would allow the Parliament to approve the audited accounts by 31 May instead of the current October and thus improve the usefulness of the report, e.g. in discussions addressing the budget of the next period.

During the year, Juhani Lemmik, the departments Director of Audit, participated as a lecturer several times in the Estonian Public Service Academy's Centre for Public Service Training and Development's training „Adaptation training of new public servants“. A workshop titled „Auditor – a helping hand or an anguishing factor?“ was organised at the Public Service Conference with the participation of many officials of the NAO. Audit manager Krista Uuna gave a report on auditing the consolidated reporting of the state at a cooperative event of the supreme audit institutions of the Baltic Republics and Nordic Countries in Jurmala. As of October, Ines Metsalu, former Director of Audit of the NAO, is practising at the European Court of Auditors.

### Important audit results

*“Implementation of Public Procurement in the Ministry of Foreign Affairs”*

All public procurements were not audited, thus the conclusions of the audit are not comprehensive. Procurements concerned with state secret were not audited as the auditors were not authorised to work with state secret.

General level of the implementation of public procurement in the Ministry is satisfactory – stages of procedure have been documented well enough and the general level of knowledge of standards of the officials organising public procurement is satisfactory. Identified infringements are the result of an accidental mistake or lack of experience rather than of malevolent irregularity.

The NAO considers it extremely positive that in cases where the Public Procurement Act had not been fully complied with, the responsible officials did not try to provide excuses but wished to find reasonable solutions for the future.

There are two problematic areas in the Ministry of Foreign Affairs – public procurements concerned with embassies and vehicles. As embassies are located outside Estonia, it is inevitable that in addition to Estonian law it is also necessary to be acquainted with the laws of the country of location. This situation causes some problems for the organisers of public procurement.

The NAO addresses vehicles as regular utility articles along with the incontestable liabilities arising from it to organise procurement, this especially in relation to repair services and spare parts. The officials of the Ministry of Foreign Affairs do not concur with the NAO. If, in the future, the Ministry of Foreign Affairs can find solutions to procurement problems concerning the embassies and shall carry out procurement for vehicles as required and reasonably, it can be assumed that nearly full compliance with the Public Procurement Act is possible in the Ministry of Foreign Affairs.

#### *“Public Procurement in the Bank of Estonia”*

To understand the specifics of public procurement in the Bank of Estonia, one must definitely take into account that the Public Procurement Act lays down an exemption for the Bank of Estonia. Due to the ambiguous and vague nature of this exemption, its implementation is convenient when the procurement is complicated or capacious or time-critical or with mutually exclusive terms and conditions, etc. In other words – the Public Procurement Act has created a situation for the Bank of Estonia, where the law can be implemented optionally and options depend first and foremost on the assessments of the management of the bank.

The NAO had not audited the Bank of Estonia in a very long time (10 years). The audit in the Bank of Estonia was emphatically correct and abundant in information from both sides, due to which it is possible (unlike in the audit of procurement in the Ministry of Foreign Affairs) to claim that all topics were addressed and a complete overview was obtained of procurements organised in 2004–2005.

According to the audit team, the employees of the Bank of Estonia are efficient enough to effectively carry out public procurements in the Bank of Estonia to purchase regular things/services/works and ensure their implementation on an equal footing with state authorities.

#### *“Organisation of tax audits”*

The audit assessed the activities of the Tax and Customs Board in performing reviews and audits of single cases. The audit identified frequent exceeding of deadlines and poor performance of audits. This shows that the tax authority does not always organise procedures with sufficient speed and effectiveness, spending resources and laying an excessive burden on the taxpayer. As a result of the audit it became clear that the problems are largely due to the poor planning of audits as well as bottlenecks in the organisation of work. The NAO is of the opinion that more efficient time control would enable the tax authority to perform at least 11 % more tax audits with same resources. As a result of the audit, the NAO made recommendations to the Director General of the Tax and Customs Board concerning the improvement of the effectiveness of tax audits by better planning and

implementing quality control. The reply of the Director General of the Board includes an action plan for the implementation of the recommendations of the NAO.

*„The activity of the Ministry of Finance in accrediting the Intermediate Bodies and Final Beneficiaries”*

The NAO audit of ‘The activity of the Ministry of Finance in accrediting the Intermediate Bodies and Final Beneficiaries’ was designed to assess whether the control measure of the Ministry of Finance – accreditation of the internal control systems of the Intermediate Bodies and Final Beneficiaries – takes into account the requirements specified in the EU legislation and whether the activities themselves have been carried out accurately.

In the opinion of the NAO, the criteria used as the basis of accreditation comply in principal aspects with the requirements for the management and audit system as specified in the legislation of the EU and the Ministry of Finance has created preconditions for implementation of accreditation as a control measure. Compared to the beginning of 2004, the quality of accreditation audits of the Ministry of Finance has improved.

Although the quality of audits has improved over the years, the Ministry of Finance has not been documenting the shaping of accreditation decisions sufficiently enough. In addition to documenting, there were also problems with preservation of accreditation documents and the exchange of information between the parties involved in the accreditation.

*„European Commission Assistance Project HASCO in Sonda Rural Municipality”*

The NAO has audited the circumstances of reclaiming the European Union assistances, based on the appeal of Sonda Rural Municipality Mayor of 21.07.2005. The audit focused on the review and analysis of the activities and documents of the assistance project ‘Oil Shale Semi-Coke Processing Into Soil Improver, Soil Improver Used to Stabilise Slurry and Restore Damaged Soils for Foresting mainly with Hybrid Aspen’ (hereinafter ‘HASCO project’) funded by the European Commission. According to the project plan, the total cost of the project was 55.5 million kroons, including 19.9 million from the European Commission and 35.7 million as self-financing from the beneficiary and its partners. European Commission has paid 505 993 euros (7.9m kroons) to launch the implementation of the project; no further payments were made by the Commission. The European Commission terminated the HASCO project on 23.02.2005 due to the fact that the reports submitted by the Rural Municipality and the visit of the Commission on 25.11.2004 did not enable assessment the results of the implementation of the project. In the same letter, the Commission submitted the claim for refunding the money.

After analysing the HASCO project materials and the explanations given, the NAO has to admit that it was difficult and on several occasions even impossible to assess afterwards the chronology of events and the content of transactions due to incomplete documentation. As a result of the audit, the NAO concluded that both the management of the project and supervision of Sonda Rural Municipality over the activities of the Rural Municipality Council were insufficient. The inactivity of the Council could have been influenced by the mutual employment contracts made between the Chairman of the Rural Municipality Council and the Rural Municipality Mayor for the purpose of implementing the project. Furthermore, in the opinion of the NAO, the demands of the European Commission were justified, because Sonda Rural Municipality had violated the aid rules:

*„Audit report of the National Audit Office on the consolidated annual report 2005 of the state”*

The NAO audited the annual accounts of the state and the report on the implementation of the state budget submitted with the consolidated annual report 2005 of the state as of 31 December 2005 as well as the additional information on local governments, the public sector and the general government sector.

The NAO made two comments on the accuracy of the 2005 annual accounts of the state. The first comment was a result of the fact that the NAO did not assess the consolidated annual report 2004 of the state, which is why there may be errors on the balance sheet as of 31.12.2005 that affect the 2005 annual accounts of the state. The second comment was based on the fact that by the time of the audit the claims and liabilities of the Agricultural Registers and Information Board had not been examined as required in the area of government of the Ministry of Agriculture, which is why the National Audit Office was not confident enough regarding the accuracy of the claims and liabilities recorded in the annual accounts of the state.

Without taking into account the effect of these comments, the NAO was of the opinion that the 2005 annual accounts of the state were essentially accurate.

Like in the annual accounts, the NAO made a comment on the legality of transactions – several state authorities have entered long-term commitments on the basis of future periods, even though the State Budget Act includes a prohibition to take a loan, use financial lease and enter into other similar commitments.

According to the NAO, except for that mentioned in the comment, the economic transactions of the sample were carried out in compliance with the State Budget Act, 2005 State Budget Act and 2005 Supplementary State Budget Act.

In addition to comments on the annual accounts of the state and the legality of transactions, the audit report of the NAO points out the most common mistakes in accountancy and main violations regarding the legality of transactions.

Juhani Lemmik  
Director of Audit, Audit Department I

### 1.3. Audit Department II

Audit Department II of the NAO audits the Ministry of Justice, Ministry of Defence and the Ministry of the Interior and the businesses in their area of government as well as companies where said ministries have majority ownership and foundations where the ministries exercise the rights of a founder.

The area of government of the Ministry of Justice does not include governmental authorities. In a wider sense, the authorities in the Ministry's areas of government comprise courts (4 county courts, 2 administrative courts and 3 circuit courts), Prosecutor's Office, prisons, Courts Centre of Accounting, Bureau of Forensic Medicine of Estonia and Centre of Registers and Information Systems. Administered authority Estonian Legal Language Centre was merged with the Ministry of Justice at the beginning of 2006.

In 2006, the budget for the area of government of the Ministry of Justice was EEK 1.2 billion according to the National Treasury's cash management report, it differs from that shown in the 2006 State Budget Act due to the funds added with the supplementary budget. The Ministry of Justice governs the shares of public limited company Estonian Prison Manufacture.

The area of government of the Ministry of Defence comprises the Information Board and Defence Resources Agency. The Ministry's area of government also comprises the Defence Forces, educational institutions of the Defence Forces and National Defence League. The Ministry of Defence administers the Laidoner Museum and Seli Health Centre. The Ministry of Defence governs the shares of public limited company E-Arsenal and exercises the rights of a founder in the National Defence Development Foundation and International Centre for Defence Studies. The Ministry of Defence participates in the financing of the Baltic Defence College that has been built as an international organisation, and also offers the College the support of the host country.

The 2006 budget of the Ministry of Defence was EEK 3.5 billion according to the National Treasury's cash management report, it differs from that shown in the 2006 State Budget Act due to the funds added with the supplementary budget.

The Ministry of the Interior is the ministry with the largest and most complicated area of government: its more than 100 authorities employ over 14,000 people. The area of government of the Ministry of the Interior comprises the Police Board, Border Guard Administration, Rescue Board, Security Police Board, Citizenship and Migration Board and Data Protection Inspectorate, also county governments with the agencies under their administration, and the Estonian Fire-fighting Museum. The area of government of the Ministry of the Interior comprises the Forensic Service Centre as a national specialised police authority. The Ministry of the Interior administers the Estonian Public Service Academy, an institution of professional higher education for public defence. Militarily organised Muraste Border Guard School, state vocational educational institution for public defence, and Neeme Border Guard Dogs School were merged with the Ministry of the Interior in September 2006.

As of 31.12.2006, the area of government of the Ministry of the Interior comprised over 100 authorities and the 2006 budget for the Ministry's area of government was EEK 5.14 billion according to the National Treasury's cash management report, it differs from that shown in the 2006 State Budget Act due to the funds added with the supplementary budget. Considering the extreme complexity of the area of government of the Ministry of the Interior, it must be noted as a clarification that the state budget differentiates between the budgets of the areas of government of the Minister of the Interior and the Minister of Regional Affairs, the latter includes the budgets of county governments. The expenses of authorities administered by county governments are prescribed in the budgets of the ministries whose area of activity comprises these authorities on the basis of their activities. National Treasury's cash management report includes these expenses in the expenses of the area of government of the Ministry of the Interior.

The Ministry of the Interior governs the shares of public limited company Andmevara. Additionally, the Ministry of the Interior or an authority in its area of government exercises the rights of a founder in 21 foundations and is a member of 12 non-profit associations.

Audit Department II had 16 positions - 1 director of audit, 3 audit managers, 5 senior auditors, 5 auditors and 2 junior auditors. At the beginning of 2006, 10 of these positions were filled: director of audit, 2 audit managers, 3 senior auditors and 4 auditors. During the year, the department employed two new people who were promoted to the position of audit manager in the middle of the year. One audit manager, one senior auditor and one auditor left the department in 2006. By the end of the year, 9 positions were filled. In 2007, the department plans to fill 4 positions, the positions of 2 junior auditors, however, shall be eliminated, as the department does not need employees of such qualification to meet its objectives.

The department's principle objective was to create prerequisites within the department for performing quality audits that would have a positive effect on Estonia. Three main prerequisites were defined: personnel with high qualifications (very good skills of analysis and expression in writing, professional experience in private sector or state authority's policy-making area, knowledge of the functioning of the Estonian society and knowledge of state organisation); implementation of modern culture of management and work as well as implementation of rational work methods; stress-free working environment supporting development and good results.

Another strategic objective was a functioning and resource-saving assessment system for monitoring and risks in the Ministry of Justice, Ministry of the Interior and Ministry of Defence. It was established by the end of the year, but needs further developing also in 2007.

The third strategic objective was to abandon the so-called clean financial audits (except for the Audit to check accuracy of the annual accounts and legality of transactions of the Ministry, the methods of which shall be prescribed by Audit Department I) by including the aspect of performance audit. The department has already abandoned the clear differentiation between financial auditors and performance auditors, the described way of thinking has been adopted and already successfully implemented in first audits (e.g. land hire purchase claims administration audit).

During the year, 15 audits were started and 8 audits were completed, including 5 financial audits and 3 performance audits. By the end of the year, 4 audits (2 financial audits, 2 performance audits) were not completed due to extensive changes in teams and departure of several employees. 7 audits were excluded from the work schedule due to the lack of resources or it was decided after the termination of pre-studies that it would be more reasonable to use the resources for other audits. 5 new audits were stated at the end of 2006. In 2007, 16 audits and a special project (recommendation for limiting and organising the ministry's administrative and political management) shall be completed. It will be possible to meet this objective if the planned recruitment will be a success and no factors impeding work will be added.

In 2006, Audit Department II performed other overviews and analyses on the request of the Parliament, Government and Chancellor of Justice (e.g. on the request of the Prime Minister, he was given an overview of the funds actually spent on the remuneration of officials of rescue service and the principles of its allocation, the NAO participated in the improvement of a control system for financing political parties, gave an assessment on substance for the add-ons implemented in prison shops, etc.). The NAO also assessed planned larger projects from the viewpoint of sustainability, efficiency and effectiveness (e.g. Estonian Public Service Academy's relocation project) and participated in the meetings of the field's opinion-formers, incl. with a report at the internal security meeting of the Academic Council of the President of the Estonian Republic.

Employees of Audit Department II have used the training opportunities offered to them in a responsible manner. The main stress was put on individual development, further study of international standards (INTOSAI, IFACi ISA) and improvement of the field's knowledge through the department's strategic seminars. The employees also participated in training exercises for crisis management.

There are regular meetings with the internal auditors of the Ministry of Justice, Ministry of Defence and Ministry of the Interior to discuss both methodical issues and issues related to work schedules.

Thanks to the frequent observations and recommendations of the NAO, the Ministry of Defence has hastened the transfer of assets returned to the National Defence League and legal formalisation of the transfer of ownership. In the audit of the National Defence League's economic transactions, the NAO drew attention to the inefficiency of the activities and poor organisation of management of the Kaitseliidu Kinnisvara foundation. As a result of comments, the National Defence League has renewed the composition of the foundation's Management Board and Supervisory Board and hopefully, the assets of the National Defence League shall be governed and developed in a more purposeful and effective manner in the future.

As a result of the land hire purchase claims administration audit, the Ministry of the Interior has begun to adjust and harmonise the accounting of land hire purchase claims. Upon accounting the land hire purchase claims and revenue, the Ministry of the Interior has decided to continue with the LIS (Land Information System) computer program by developing and introducing it also in those county governments that have been using other program. Single instructions and application for the LIS accounting program for finding land hire purchase claims for reporting have been developed. Central database of hire purchases shall be transferred from the Ministry of Finance to public limited company Andmevara in the area of government of the Ministry of the Interior, who shall be the processor and program developer for the central database.

### **Important audit results**

#### *“Waiting lists for forensic examination”*

In the course of identifying the reasons for extremely long waiting lists for forensic examination the NAO found that there were over 1,000 expert analyses on the waiting list without a clear explanation what they were needed for, in many cases the judicial proceedings in relation to what the analyses were no longer in process.

As a result of the NAO's work, an inventory of examination rulings was arranged for in cooperation with the Public Prosecutor's Office, Police Board and police prefectures, 2129 unnecessary orders for expert analyses of DNA were cancelled. Poor quality of examination rulings was one of the reasons for long waiting lists for expert analyses, as a result of the audit the quality control of examination rulings has been improved. The recommendations of the NAO to shorten the waiting lists for expert analyses have mostly been followed (or started to follow) in 2006. Internal audit performed in the Police Board in 2006 revealed that waiting lists for expert analyses of DNA have shortened by 30 %. For instance, the Chief Public Prosecutor issued instructions for the more purposeful use of the resources of criminal procedure, an inventory of expert analyses in the waiting lists was organised, the budget of Forensic Service Centre (FSC) was increased and the centre's internal structure changed, etc. Arising from this, the waiting lists for expert analyses of DNA should continue to decrease and the situation should be better by the end of 2007. Mutual cooperation of forensic institutions has improved and as of the the end of 2006 the Bureau of Forensic Medicine of Estonia began to carry out DNA analyses for the FSC as professional assistance. The problem should be fully solved within the next two years when the mentioned forensic institutions shall be merged and the use of resources shall become significantly more sustainable and the activity more efficient.

#### *“Accounting land hire purchase claims and ensuring accruals”*

The purpose of the audit was to assess the accounting of payment of hire purchase amounts for privatised land and the means taken for ensuring the accrual of the amounts receivable.

It became clear that the used information technology databases do not support ensuring the accrual of hire purchase payments for privatised land. The inadequacy of the databases does not allow for a thorough analysis or monitoring of payment of hire purchase amounts. Delaying the collection of

debts generates a risk that in the case of the bankruptcy of the debtor the state will not receive the amount payable for the land. Due to the unclarity of the possibilities of compulsory execution and deficiencies of the system of administration of claims the hire purchase debts are let to grow in practice. The audit revealed to the public that upon resale at market price of the land privatised on favourable terms and conditions, the new owner is permitted to continue payments for the land to the state by way of hire purchase instead of demanding immediate payment of the entire purchase amount. In current conditions, the new owner is usually capable of immediately paying the purchase amount and granting of new favourable terms, substantially a cheap loan, is clearly not justified. According to the NAO, the law should allow for the demand of immediate payment of the entire purchase amount upon resale. Upon assessing the incurring damage, the cost of the long-term administration of claims must also be taken into account.

*“Prevention of fires in residential buildings”*

The most relevant result of the audit is that a strategy for the preventive work in the field of rescue for the next four years has been approved and it will include the objectives measured upon reducing the number of deaths caused by the fire and damages from fires. The importance of prevention work is emphasised more than before. Unfortunately, the amount of damage from deaths caused by the fire has not decreased so far.

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There is reason for mentioning the analysis of the sustainability of leasing buildings to state authorities, the results of which were recognised by the Auditor General in an overview of the use and preservation of state assets in 2006. So the focus was again drawn to the damage arising from the failure to reach an agreement on the real estate policy of the state. If the state rents office buildings to be used for a long time by authorities, whose functions do not disappear, it is in a long-term perspective generally more harmful than acquisition, construction or renovation of buildings into state ownership. Upon entering a residential lease relation, the profit of the developer is generally also paid for in addition to the loans the developer has taken to improve the premises. Concluded contracts do not usually allow for a release from the administration duty of buildings or cancellation of the lease contract, rather, the state has taken long-term inalterable financial obligations, foreseen the relevantly large increase of the rent and put itself into a position where, at the end of the lease period, it is forced to continue leasing the premises under the terms and conditions set by the lessor.

The NAO also pointed to the fact that the role and vision of Riigi Kinnisvara AS are unclear. Substantially, Riigi Kinnisvara AS, whose activity can be influenced by the state by governing its shares, has turned into just another private sector tenderer among others. Undoubtedly, the preference for lease relation may hide an ideological or macro-economic consideration, but this should not justify the axiomatic preference of lease relation without further contemplation in each specific case. If the need for office premises should arise, the NAO recommended always determining the need for space regarding both volume and time, fixating in writing the alternatives for satisfying the need for space and the reasons for adopted decision. Naturally, the demands for the premises to be rented should be submitted to all possible suppliers at the same time and in the same manner, in order to get comparable offers.

This has not been the case in current practice. Documentation of the analysis preceding the renting allows for a retroactive examination of the decision of renting and thus enables to eliminate the doubts that one lessor in the private sector was preferred to another or that the lease contract has been concluded at unfavourable terms to the state.

Ülle Madise  
Director of Audit, Department II

## 1.4. Audit Department III

Audit Department III audits the area of government of the Ministry of Education and Research, the Ministry of Culture and the Ministry of Social Affairs. The expenses of the areas of government of these three ministries form a little over half the expenses of the state budget; biggest amounts go for the payment of health insurance and pensions. The total number of audited state authorities is 108; the number of legal persons governed by public law and foundations founded by the state is 45. In addition to them, 4 companies are audited.

As of the end of 2006, the department employed 19 officials – 15 auditors and senior auditors, three audit managers and director of audit. During the year, one official left the department and 2 new officials were employed. Both new employees have long-term professional experience from working in the public sector.

The auditors are specialised either financial audits or performance audits. All auditors have their own area of monitoring, where they observe changes, incl. compliance with the recommendations made in the course of previous audits. They also observe the development of legislation addressing the department's sphere of responsibility and, if necessary, submit recommendations for their supplementation on the basis of previous audit results and monitoring.

In 2006, the department carried out 22 audits, 13 of them were completed. Most of the completed audits were financial (compliance) audits. Three of them dealt with the organization of accounting and legality of transactions of the ministries in 2005 and were carried out with the purpose of providing an opinion of the NAO level to the consolidated annual report of the state. In the course of the rest of the audits the NAO assessed the economic activities of a separate legal person, or the legality of the control system of allocations provided in the state budget of the use of money (e.g. use of funds allocated from the state budget to local governments for subsistence benefit).

Performance audits focused on topics of how the state budget funds could and should be used more efficiently (rehabilitation of persons with special needs) if there have not been clear criteria for the allocation of funds (granting investment aid to local governments by the Ministry of Culture) or if the issue concerns finding solutions for relevant problems concerning many people (education opportunities of children with special needs).

Mostly the auditees included state authorities but our audits also covered the economic activities of several legal persons governed by public law (National Library of Estonia, Tallinn University, Estonian Television) and foundations founded by the state (Foundation for Building the Art Museum).

All audit reports were forwarded to the State Budget Audit Committee of the Parliament. In several cases the standing committees of the Parliament were informed of the results of the completed audit, and those committees organized discussions of audit results where necessary. For instance, the Social Affairs Committee of the Parliament discussed thoroughly the results of audits on the organisation of paying subsistence benefits, use of funds allocated for the rehabilitation of persons with special needs and efficiency of the organisation of rehabilitation, calling on the relevant ministers, ministries' officials and representatives of related parties to participate in the discussion.

In addition to audits, the department analysed the lease contracts for premises rented by the state and prepared a separate chapter titled "State investment funds for local governments" into the overview of the use and preservation of state assets submitted to the Parliament.

The reports that have been drawn up as a result of the audits contain many recommendations for eliminating shortcomings, improving the control system and of making the activities more efficient. In most cases, the compliance with recommendations has been good. However, it must be taken into consideration that compliance with some recommendations shall inevitably take more time. Several explanatory memorandums for Acts note that the recommendations of the NAO (e.g. draft Act to amend the Parental Benefit Act that was completed at the end of 2006, procedure for allocating

investment aid from gambling tax established by the Government) have been taken into consideration upon their preparation. Financial management and accounting of the ministries has improved, its level in the authorities of the area of government, however, is still uneven.

### **Important audit results**

#### *“Investments allocated for local governments by the Ministry of Culture”*

The NAO audited the distribution and use of investment aids allocated for the local governments by the Ministry of Culture. The purpose of the audit was to assure that allocation of funds from the state budget is transparent and reasoned and these funds shall provide that what had been applied for and what had been promised. The NAO concluded that the system for the allocation of funds is insufficient. Problems were identified in the legal basis for the system and in the substance of adopted decisions. As a result, the investment decisions are not transparent and it remains unclear who is responsible for inefficient investments. In the agreements for the allocation of investment aid, the state and local governments did not agree precisely enough on the intended purpose of and terms for the use of funds. Control over the funds allocated for investments was poor.

The Ministry of Culture promised to supplement legislation and other regulation in relation to the allocation and recovery of appropriations. Necessary amendments shall be entered into the Regional Development Management Act as well as into the Ministry’s instructions. Finance Committee of the Parliament submitted the wishes of the Parliament concerning the investment aid for cultural objects from the 2006 supplementary budget first time to the Ministry of Culture in an official letter.

#### *“Education opportunities of children with special needs”*

The NAO investigated the educational opportunities of children with special needs in order to assess whether the created opportunities take the special needs of the children into account and allow them to manage in life later. The NAO identified several shortcomings in the state’s organisation, noticing children with special needs at an early stage and in education opportunities created for them. The analysis of the effectiveness of the teaching system created for the children with special needs assessed the children’s fate after obtaining the basic education. It was found that a fifth of the people having the capacity for work, who have obtained basic education at a special needs school or class, do not study or work. 42% of the persons with special needs who could potentially work have not gone to work, they have not continued their studies or have broken off their further studies after acquisition of the basic education. Studying in a special needs school and a special class of an ordinary school has produced similar results in terms of the fate of the students after the basic school. In more serious cases (children with a moderate or severe mental disability) the special needs schools have achieved better results and children with standard intellect have achieved the best results in an ordinary class of an ordinary school.

In the 2007–2013 draft development plan for general education system, the Ministry of Education and Research has drawn attention to several bottlenecks pointed out by the NAO and taken the made recommendations into account. There shall be relevant changes in the counselling system of both students and teachers, the issue of teaching aids of children with special needs is being addressed, necessary diagnostic materials and instructions shall be developed. A new financing model for the general education system is also being prepared.

#### *“Effectiveness of organisation of medical rehabilitation”*

The audit revealed that only 19 % of those who needed medical rehabilitation had received it and that only half of them received it in a timely manner. The analysis indicated first and foremost the cost-effectiveness of the medical rehabilitation of cardiology patients, because their later average treatment expenses in the case of receiving medical rehabilitation were lower. Cardiology patients who had received medical rehabilitation were also likelier to return to work.

The NAO found that the availability of the medical rehabilitation service does not depend so much on the medical rehabilitation needs of the patient, but on the existence of the medical rehabilitation service provider in the proximity of one's place of residence. This is especially characteristic of the outpatient service. Likewise, it became clear that medical rehabilitation was received by patients who did not need it and there have been cases where patients were provided with inpatient medical rehabilitation (which is more expensive) due to poor availability of outpatient medical rehabilitation.

Like all other medical specialties, the availability of medical rehabilitation is affected by the possibilities and priorities of the budget of the Health Insurance Fund. Additionally, the increase of the availability of the medical rehabilitation service is also limited by the lack of specialists.

On the basis of the audit, the NAO concluded that the availability of the medical rehabilitation service must be improved and this especially in terms of the availability of outpatient service. The Minister of Social Affairs and the Chairman of the Management Board of the Estonian Health Insurance Fund concurred with the NAO's opinion. Based on the 2007 budget of health insurance, it can be said that the NAO's recommendations have been taken into account and sums spent on medical rehabilitation have increased on the average more than sums allocated to other specialties. The number of medical cases has also increased, especially in outpatient cases.

*“Outsourcing services for rehabilitation of people with special needs from the state budget”*

In the course of the audit, the NAO concluded that the system designed for rehabilitation of people with special needs is not sustainable and does not generate any prerequisites for achievement of the goals of rehabilitation. According to law, all disabled persons and persons who are applying for a degree of disability are entitled to rehabilitation services, but the funds allocated for such purpose in the state budget were scarce and therefore there were long waiting lists of those who liked to receive the service. In 2005, less than 10 % of the target group received the services, only a rehabilitation plan was drawn up for most of them and the service itself was never provided. The Ministry of Social Affairs has tried to cut the waiting lists by determining the financial volumes by target groups in 2006, preferring disabled children and people of working age, but the law does not provide for such an opportunity. The audit showed that even in the case of restrictions there were waiting lists among the so-called preferred target groups in 2006.

However, the same waiting lists may cause an unnecessary waste of money, as the services are provided only on the basis of the rehabilitation plan, which is made for a period of six months to three years. The rehabilitation plan may become outdated during the waiting period and a new rehabilitation plan must be drawn up to receive the service. In that case the money spent on drawing up the rehabilitation plans has been wasted. Namely, over half the funds were spent on rehabilitation plans as well as on accommodation and travel expenses, which is why there was not enough money for the activities that would help persons with special needs to better cope in life. The rest of the services lack standards, and because of that the same service may differ significantly in rehabilitation institutions.

The results of the audit were discussed in the Social Affairs Committee of the Parliament and State Budget Audit Committee of the Parliament. In 2007, the volume of medical rehabilitation service has been increased significantly, and unlike in previous years, the state budget provides the funds for the medical rehabilitation of disabled children on a separate budget line. The Ministry of Social Affairs plans to develop standards for the service and strengthen control systems.

*„The use of money allocated from state budget to local governments for paying subsistence benefits”*

The granting of subsistence benefits has been placed within the competence of local governments, but at the same time the Ministry of Social Affairs has not performed its duty of coordinating social welfare adequately. There are several deficiencies in the Social Welfare Act that significantly complicate the granting of benefits. The audit revealed that the granting and paying of subsistence benefits in local governments has been organised differently.

The NAO found that the control systems do not ensure the payment of subsistence benefits only to those in need. The beneficiaries in the sample had often not informed the social workers of their incomes, which caused the payment of the benefit on the basis of incorrect data. The incorrectly paid amounts formed 4.6% of the audited benefits. Proprietary situation of families was also not taken into account when granting the benefits, although local governments are entitled to do that. Thus, many persons owning several real estates, vehicles or land received the benefit. The granting and paying of subsistence benefits to such persons/families became possible only because the social workers did not verify the data on the persons from the Tax and Customs Board database, traffic register or land register.

As a result of the audit, the NAO made recommendations the compliance with which shall facilitate the granting of benefits and shall strengthen the control system.

*“Economic activities of Tallinn University”*

As a result of the audit, the NAO reached the conclusion that the accounting management of the University’s economic transactions is weak and the internal control system needs to be improved.

In some cases, no public tender had been organised to find lessees and the concluded rental contracts included unfavourable conditions to the grantor. The University did not have a comprehensive overview of the rental contracts.

In making investments, the internal control system did not function when accepting performed works and when paying for them. Due to the deficiencies in the internal control system and management of accounting, it had become possible that there were errors in the documentation of cash transactions and the money from sales was received later than the specified due date; the fuel cards registered to cars were used when the cars were in the University garage; in several cases, the University had paid for works and services without having concluded prior contracts and/or preparing statements of acceptance of work, etc. In some cases, the payment of remuneration was registered as the payment of scholarship to evade paying taxes.

After the audit, the University Senate approved a plan for measures, including the deadlines and persons responsible for the refinement of the internal control system. It revised the cost of student places not funded from the state budget, developed new statutes for the University’s scholarships and accounting policies and procedures, established a procedure for concluding agreements and observing compliance with them, taxes on illegally paid scholarships were paid to the state, etc.

*„Economic activities of the Foundation for Building the Art Museum”*

The objective of the audit was to assess the economic activities of the Foundation in 2001-2005, as well as to establish the cost of building the museum and the reasons for its growth compared to the estimated cost.

The growth in the construction cost of the Art Museum of Estonia when compared to the initially estimated cost was EEK 264 million, and EEK 77.7 million after awarding of the contract for services. The actual cost was EEK 864 million. The cost of the new building of the Art Museum increased due to the construction of the tunnel, a slight shift in the initially planned location, modifications to the project, additional architectural solutions, additional works, several changes regarding building materials and furniture, and a great number of commissioned expert opinions. The Foundation had commissioned expert opinions on the circumstances of the rise in the cost of the building and the Supervisory Board of the Foundation had accepted the increases. Therefore, the NAO had no reason to doubt that the cost increase was unjustified.

However, the changes in the scope of some works that caused the increased cost were not sufficiently documented and in some cases, the Management Board of the Foundation was not active enough to find opportunities for saving. In most cases, public procurements were organised in the prescribed

manner. At the same time, it became evident that in some cases, public procurements were not organised (e.g., for finding the organiser of asset sales, contracting for additional preparatory works of the construction, etc.).

Although pursuant to its articles of association, the Foundation may use its revenues and assets only to reach the objectives specified in the articles of association, it had incurred the expenses that should have been incurred by the Art Museum several times. The audit identified such expenses in the amount of EEK 3 million.

Deficiencies were detected in awarding the contracts for employment and service, and calculating remuneration on the basis of these contracts, as well as registration of assets.

The Minister of Culture notified that the Supervisory Board of the Foundation will take into account the recommendations made in the audit report in the future. The Management of the Foundation informed the NAO of the measures taken to improve the internal control system.

*“European Social Fund measure 1.3 “Equal opportunities in the labour market””*

During the audit the NAO assessed the fulfilment of the recommendations regarding improvement of the control systems made in the previous audits of measure 1.3, the organisation of the control system of the implementing agency and final beneficiary and the compliance of the organisation of the projects included in the sample with the planned organisation.

The audit revealed that the recommendations made during previous audits have been largely taken into account and the control system of support proceedings has been improved, but the main problem upon implementation of measure 1.3 has been the excessive complexity of the process, which has required additional work on the part of the implementing agency, the final beneficiary as well as the implementers of the project.

The NAO saw a problem in the fact that the audited projects were changed a lot and it had turned into an everyday activity. There were also cases, where projects’ budgets were amended only after it turned out that some of the already made expenses were not eligible. The NAO disapproved of the establishment of the budget amending procedure only in the course of the audit.

The NAO audited the implementation of three projects of the European Social Fund and found that the projects had generally succeeded according to plan. However, in the course of the audit it became evident that projects’ funds are not fully spent and the NAO recommended to quickly complete the projects whose objectives had already been met so that the remaining funds could be distributed to other projects. The Labour Market Board took the NAO’s recommendation into account and said projects were completed.

Jüri Kõrge  
Director of Audit, Audit Department III

## 1.5. Audit Department IV

Audit Department IV evaluates the Ministry of the Environment, the Ministry of Agriculture and the Ministry of Economic Affairs and Communications as well as state authorities operating in their area of government; legal persons governed by public law and foundations whose rights of a founder or rights of members are performed by abovementioned ministries. The department also audits companies where the ministers at the head of said ministries have an obligation to represent the state's interests in carrying out the state's majority interest in said companies.

The auditees of the Department also include the foundation Environmental Investment Centre, whose rights of a founder are exercised by the Ministry of Finance.

There were 19 positions in the department – one director of audit, 3 audit managers, 2 senior auditors and 12 auditors as well as one junior auditor. At the beginning of 2006, the department employed 14 people – one director of audit, 3 audit managers, 2 senior auditors and 8 auditors. During the year, 3 new auditors were employed and a director of audit and 2 auditors left the department. The employment contract was suspended for two employees, one of whom left to study and the other is on parental leave. By the end of the year, the positions of a director of audit, 2 senior auditors and one junior auditor were not filled. The department's principal problem in 2006 was the lack of auditors with long-term auditing experience.

The department's objectives for 2006 included auditing of the preparation of larger environmental projects funded by the European Union and the effectiveness of agricultural refunds. The audits draw the state's attention to the shortcomings identified in the use of the EU support and provide recommendations for their prevention in the implementation of the EU structural aid strategy launched in 2007.

The department also focused on evaluating the organisation of management of state companies and foundations so as to find an answer to the question whether the supervision of the owner and founder in state companies and foundations has been organised in a purposeful and functioning manner. The department audited regulations, ministers' activity in governing holding and execution of the rights of a founder and supervisory activities of the supervisory boards of companies and foundations.

During the year, 17 audits were launched and 9 audits were completed with an audit report, including seven of those that had started already in 2005. 5 of the completed audits were financial audits and 4 were performance audits. The preliminary analyses for three audits led to the decision that audit procedures are not necessary. In addition to auditing procedures, the department prepared a part of the overview on the use and preservation of state assets, which was submitted to the Parliament by the Auditor General.

Last year, the department's audit managers participated in several international trainings. Audit manager of the area of financial audit took part in the international training programme "Auditing in the environment of information technology" in India, and the audit manager of the environment participated in the international course of performance audit in London, organised by the National Audit Office of the United Kingdom.

Employees of the department also represented the NAO in the international working groups of supreme audit institutions INTOSAI and EUROSAI.

Recommendations of the audit "Handling of issues related to rape and bio-diesel fuel by the Government" were discussed by the Government, who decided to develop a "2007–2013 Development Plan for Promoting the Use of Biomass and Bioenergy" for the further analysis of bioenergy issues. The ministry responsible for the development of said plan is the Ministry of Agriculture. The development plan was submitted to the Government for approval in January 2007.

To meet the recommendations of the 2005 audit “Exploitation of peat resources”, the Government established with the Regulation “Critical and usable reserves of peat and its annual rates of use” smaller rates of use, which led to the suspension of issuance of extraction permits till the completion of additional surveys. Rates of use of peat shall be reviewed upon the completion of a survey “Identification of the increment of Estonian peat resources”. With the Environmental Fees Act, the fee for extraction of well-degraded peat was increased as little as possible.

In addition, the Ministry of the Environment ordered a survey of abandoned peat fields, which has been completed in three counties. Based on the results of the survey, the extraction rates of peat shall be reviewed again in 2007, increasing rates first and foremost for extraction in abandoned fields. Preparation of instructions of re-cultivation of peat fields has also begun.

### **Important audit results**

#### *“Hazardous waste handling in intermediate depots and landfills”*

With the audit, the NAO assessed the activity of the state in organising the handling of hazardous waste (except for waste generated by oil shale processing).

With the help of foreign financing, the state has established and furnished the first modern handling centres for hazardous waste in Tallinn and Vaivara, thus successfully launching a handling system for hazardous waste. In addition to centres established by the state, the private sector engaging in collecting and processing of hazardous waste has also developed. The centres established by the state currently handle 5 % of all accounted hazardous waste (not including the waste of oil shale processing). In its audit, the NAO draws attention to the need to change the contracts concluded with the operators of centres in a way that would ensure the admission of all hazardous waste, or take into consideration the partial or complete transfer of these centres.

The NAO also draws attention to several shortcomings in the organisation of said field. The environmental impact of handling hazardous waste has only been assessed in a few cases and the environmental protection and monitoring requirements in licences and permits are uncertain or altogether absent. There are problems with insufficient supervision over the activities of waste handlers. This is partly due to the fact that the authorities performing supervision do not possess sufficient knowledge for addressing the problems of this technically complicated field.

In his letter of reply to the draft audit report, the Minister of the Environment stated that he does not concur with a lot of information presented in the report and/or observations and proposals made on the basis of it, and that he considers them impractical and superficial. At the same time the Minister did not contest any particular fact presented in the audit report. In several cases he contested viewpoints and statements not presented in the audit report.

The Minister is of the opinion that the prices of hazardous waste handling can only be kept at levels acceptable for waste producers with the help of state support. The NAO does not find the Minister’s explanations on why it is necessary to keep the centres established by the state in state ownership to be sufficiently reasoned. The NAO feels that instead of acting as the owner of the centres the state has numerous other possibilities to support waste handling and the Ministry of the Environment should once more thoroughly analyse the long-term advantages and disadvantages of the partial or complete transfer of said centres.

#### *“Activities of the Maritime Administration in collecting lighthouse and navigation dues and organising procurements”*

Although the dues charged for visiting Estonian ports are competitive compared to the neighbouring countries, the amount of tariff rates established by the state do not cover the expenditure the state considers necessary to make for the better service of ship owners. The state must decide whether it wants to cover these expenses from the income received from maritime affairs, which requires the

increasing of the rates of lighthouse and navigation dues, or from the revenue received from other fields of activity. The Maritime Administration has managed to calculate and collect the lighthouse and navigation dues satisfyingly and has collected most of the revenues. However, there have also been several mistakes.

The observations made on the basis of the audit sample allow claiming that the percentage of vessels from which lighthouse and navigation dues have not been collected is estimated to be 1.4. Due to the misinterpretation of law, the lighthouse dues have been overcharged in the amount of EEK 1.9 million; in several cases, the amounts collected from undertakings have also been smaller than prescribed. In most cases of buying, the Maritime Administration has followed the requirements of Public Procurement Act. However, the audit also revealed non-conformities with the requirements of the Public Procurement Act: the prohibition of dividing the procurement into parts with the intention of avoiding public procurements was not always adhered to, or the chosen form of public procurement was not appropriate. In some cases, the relevant documentation regarding the procurement was not preserved and there were deficiencies also in submitting the data to the state register of public procurements.

#### *“Organisation of maintenance of national roads”*

There is no efficient supervision of the compliance of the national roads with the condition requirements. The Roads Act stipulates that the duty to conduct public supervision of the compliance with the legal requirements lies with the Road Administration who is also responsible for the maintenance of the national roads. Consequently, the state has appointed the Road Administration to conduct public supervision of its own activities, which makes the efficiency of this supervision system questionable.

In the opinion of the NAO, the accounting of road maintenance expenditures is not transparent. The road maintenance expenditures of the state are planned and accounted as a part of the operating costs of the Road Administration, and the state has no precise accounting and reporting procedures for the actual expenditures. When the constantly increasing road maintenance expenditures are budgeted as a part of the operating costs, the budgeting does not provide the opportunity to evaluate the justification of the increase of the operating costs of the Road Administration.

The state cannot require from the companies maintaining the roads the achievement of the goal set in the maintenance contracts – to preserve the roads in a conditions that complies with the established requirements. As the state has been unable to repair the national roads to a sufficient extent, many of these roads cannot be preserved in a condition that complies with the established requirements only through maintenance. Over the past few years, the road maintenance contracts have become much more precise but even now they do not include clear and measurable road condition indicators that must be ensured through maintenance.

Therefore, it is difficult to assess, whether the companies have performed their obligations under road maintenance contracts. There are no reliable data concerning the economic feasibility of purchasing the maintenance of national roads from private companies.

#### *“Handling of issues related to rape and bio-diesel fuel by the Government”*

The objective set by the Parliament and the Government for 2005 – to achieve a share of 2 % of bio-fuels in vehicle fuels – was not achieved. None of the filling stations in Estonia was selling bio-fuels. It is not clear whether and how the relevant objective set for 2010 will be accomplished. The objective of starting to use fuels of biological origin in vehicles was set without prior in-depth examination of the expected economic, environmental and social impact of the production and use of such fuels. Furthermore, it has not been analysed whether it is reasonable to produce bio-ethanol in Estonia to be added to petrol.

None of the Ministries finds that it has the responsibility for increasing the use of bio-fuels in transport. Four Ministries have dealt with the issues related to bio-fuels: the Ministry of Environment (ME), the Ministry of Economic Affairs and Communications (MEAC), the Ministry of Agriculture (MA) and the Ministry of Finance (MF). The ME has been responsible for the application of the European Parliament and Council Directive and the MEAC has been responsible for the obligation under the Directive, i.e. setting the objective of increasing the share of bio-fuels in transport. Although it seems that at least two Ministries are responsible for achieving this objective, none of the Ministries has a specific action plan for completing this task.

The MEAC and the ME are of the opinion that, in addition to the excise duty exemption already established, the government should take no further active measures to guide the businesses towards decisions which facilitate the objectives set by the government. However, they admit that without such measures the achievement of the objective is doubtful.

To promote the use of bio-fuels, they have been exempted from excise tax. Plus, the EU standards for 5 % and 100 % bio-diesel have been transposed. But this has not been enough to influence the businesses towards using bio-fuels in vehicles. Many business operators believe that fuels with bio-additives may damage vehicle engines and fuel systems and they doubt whether fuel suppliers are able to ensure that the quality of bio-fuels conforms to the standards. On the Estonian market, there is currently no considerable demand for bio-fuels suitable for use in transport.

Production of bio-diesel fuel from the rape cultivated in Estonia is economically and environmentally reasonable only if the rape yield per hectare increases at least by two hundred kilograms. There are no short-term perspectives of rapid progress in terms of yield. In Estonia, rape yield is the lowest among the EU countries. Estonia does not have high-persistence varieties of winter rape which provide a high yield – the government has not promoted winter rape breeding. However, thanks to government support, rape cultivation has been one of the growing lines of agricultural production.

The Supervisory Board of AS Werol Tehased failed to accomplish its tasks in 2004. The Supervisory Board and the Management Board did not have an agreement as to the vision and business plan of the company. The Supervisory Board did not react quickly enough to the Management Board's plan to expand operations substantially and lost control over the latter's activities. In 2004, a number of mistakes were made in the management of the plant, leading to a loss of EEK 42 million for the financial year 2004/2005. Werol purchased more rape seed than the budget funds allowed, and some of it above the market price. Since the plant was unable to process the excessive stocks of seed itself, it was resold at disadvantageous prices. The loans related to these operations were not repaid in timely manner and the fines for delays led the company to payment difficulties in 2005. Werol did not comply with the rape oil supply contract made with AS Biodiesel, and the parties have failed to come to an agreement on the amount or the payment of the resulting contractual penalty. The Minister of Agriculture has not made an assessment as to the activities of Werol's Supervisory Board in 2004.

Tarmo Olgo  
Director of Audit, Department IV

## 1.6. Audit Department V

Audit Department V assesses the internal control, financial account and financial reporting of local governments, foundations and non-profit associations founded by local government or whose member the local government is; of companies, local government has control through majority holding or in another way; of the subsidiaries of said companies; the legality of economic activities and reliability of information systems.

Audit Department V was established at the end of 2005 and its positions were filled as of the beginning of 2006. There were 19 positions in the department – one director of audit, 3 audit managers, 6 senior auditors, 5 auditors and 5 junior auditors. At the beginning of 2006, 14 of these positions were filled – 1 director of audit, 3 audit managers, 3 senior auditors, 3 auditors and 4 junior auditors. During the year, another junior auditor was employed by the department, 4 junior auditors were promoted to the position of auditor. At the end of the probation period, one auditor left the department. 15 positions were filled as of the end of the year.

In its first year, the department set three objectives for itself. The first was to launch the activities of the department (fill the positions, train employees, identify the problems of the audited field and carry out initial risk assessment and based on that, start the first audits). The second objective was to obtain a sufficient amount of base material by auditing local governments of different size so as to identify main problems of the local government's financial account and internal control system. This enables the department to focus on the problematic areas in the next year. The third objective was to start the first wider problem audits.

The department spent the first three months on filling positions, collecting area-related information and defining first audits. Auditing began in April. During the year, 14 audits were started and 7 audits of local governments and one problem audit in the area of IT were completed with an audit report. In addition, the department prepared one part of the overview on the use and preservation of state assets, which was submitted to the Parliament by the Auditor General.

Due to the fact that Audit Department V started work in 2006, one of the main activities besides auditing was training of employees. Additionally, at local government associations, the employees of the department met with the representatives of local governments, in order to give an overview of the NAO's competence in auditing local governments as well as its objectives and activities planned for the next few years. At the end of the year, the department engaged actively in introducing audit results and analysing opportunities for improving the situation.

The audits resulted in an overview of financial accounts and internal control systems of local governments and in the notification of problems at both local and state level. Local governments are extremely interested in the NAO's audits and viewpoints and analyse the problems addressed in audits also in their units. Additionally, several organisations supporting the development of local governments have shown interest in contributing to finding solutions to problems, promising to organise seminars and discussions with the representatives of local governments. Here, tentative agreements have been reached. Actual activities directed at the improvement of situation shall take place in 2007.

The audit "State support to local governments in developing the information society" launched an active discussion at state level on whether local governments are capable of independently coping with duties imposed on them for the development of information society, or do they need the state's support. During 2006, the NAO introduced the topic in many events through reports and discussions. Specific solutions have also been discussed with the Minister of Regional Affairs, who is responsible for the management of the general development of local governments in the state. On the initiative of the Minister of Regional Affairs and in cooperation with E-Governance Academy, an information society development plan for local governments is being developed, which should provide solutions

for the problems pointed out by the NAO. According to the NAO, it is relevant to reach an agreement on who shall be the state partner of local governments in the area of IT.

### **Important audit results**

In 2006, the NAO completed audits in seven local governments: Rural Municipalities of Saare, Vormsi, Rakke and Toila and in the Cities of Kiviõli, Kuressaare and Paldiski. In all audits, the NAO's objective was to assess the functioning of internal control system implemented to ensure the purposeful and lawful use of local government funds and assets, compliance of the organisation of accounting with legislation and instructions regulation accounting as well as the legality of economic activities.

The NAO identified shortcomings in the internal control systems of all auditees. Among the more relevant problems were insufficient activities of the audit committee, poor availability of information subject to public disclosure, failure to comply with established procedures or their obsolescence as well as the non-transparency of budgeting.

Relevant shortcomings were also identified in accounting and its organisation, which is mostly due to the fact that local government does not have enough money to recruit and train competent accountants. In their work, the accountants do not implement or are not familiar with the requirements accompanying the amendments to acts. The accountants' skills of accounting programs are poor, and general there is lack of effective on-the-user support. It must also be noted that rural municipality mayors and city mayors do not recognise their responsibility for the organisation of accounting as well as for its authenticity, which is why the respective area and accountants have been left without necessary support.

As fixed assets generally form 80–90 % of the local government's assets, accounting of fixed assets was audited in all units. As a result of the audits it was concluded that accounting of fixed assets and recognition of economic transactions concerning fixed assets in local governments is extremely poor. This has led to a situation where all audited local governments do not have an overview of their assets and their value.

The audits provided several recommendations for the improvement of the situation. At the end of the year, a summary of more relevant problems was drawn up and communicated to all local governments and relevant ministries, so as to bring their attention to potential problems and need to improve the situation.

#### *“State support to local governments in developing the information society”*

The NAO audited the support provided by the state to local governments upon development of the information society. Although Estonia has gained international acknowledgement as a successful and enthusiastic developer of the information society, the NAO finds that not all the sides of the e-state and the information society have received equal coverage. So far information technology solutions, requests and needs of local governments have been left out of the overall organised development of the information society in the state. There are state endeavours meant for the local level, notably the successful Tiger Leap and Village Road projects as well as establishment of Public Access Internet. At the same time these activities have been aimed directly at the population, while the needs and difficulties of the local governments themselves have been left without attention. The local governments have not received sufficient support from the state in developing the information society.

As a result of the gap between the state and the local level in developing the information society, the inevitable loser will be the citizen for whom the service providing level or authority is irrelevant when communicating with the public authority and consuming public services. For the citizen the speed and convenience of provision of the service are important and it should be the priority for the public authority as well. If the local government has difficulties with fulfilling this expectation of the citizen, the state's duty is to provide support.

According to the NAO, the state has not paid enough attention to involving the local governments in the development of the information society. Provision of the state support or coordination of the area to that end has not been made the duty of any agency. In the current stage of development of the information society as a whole it is necessary that the Government of the Republic pay more attention to the area at the level of the central and local government.

The NAO made a recommendation to the Minister of Regional Affairs to develop a competency centre and a network for coordination and support of the information technology development of the local governments on the basis of the recommendations set out in the IT Interoperability Framework and the Information Society Development Plan Implementation Plan.

Krista Aas

Director of Audit, Department V

## **1.7. NAO audits in 2006**

Audits are listed by ministries and their areas of government. If one audit concerns the area of government of several ministries, it will be listed under every ministry in question.

### **Ministry of Education and Research**

10.11.2006 – Education opportunities of children with special needs

29.09.2006 – State support to local governments in developing the information society

24.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Education and Research for the purpose of assessment of the consolidated annual report 2005 of the state

07.04.2006 – Economic activities of Tallinn University

### **Ministry of Justice**

13.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Justice for the purpose of assessment of the aggregate annual report 2005 of the state

### **Ministry of Defence**

24.08.2006 – The opinion of the NAO on the annual accounts 2005 of the Baltic Defence College

26.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Defence for the purpose of assessment of the consolidated annual report 2005 of the state

### **Ministry of the Environment**

09.08.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of the Environment for the purpose of assessment of the consolidated annual report 2005 of the state

12.07.2006 – Hazardous waste handling in intermediate depots and landfills

### **Ministry of Culture**

14.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Culture for the purpose of assessment of the consolidated annual report 2005 of the state

10.07.2006 – Investments allocated to local governments by the Ministry of Culture

26.06.2006 – Economic activities of Estonian Television

18.04.2006 – Economic activities of the Foundation for Building the Art Museum

13.03.2006 – Economic activities of the National Library of Estonia

### **Ministry of Economic Affairs and Communications**

29.09.2006 – State support to local governments in developing the information society

10.08.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Economic Affairs and Communications for the purpose of assessing the consolidated annual report 2005 of the state

10.07.2006 – Organisation of accounting and the legality of the transactions of the Maritime Administration in 2005

26.04.2006 – Organisation of accounting and legality of transactions in the Road Administration, the Northern Regional Road Administration and the Viru Road Office

31.03.2006 – Activities of the Maritime Administration in collecting lighthouse and navigation dues and organising procurements

13.02.2006 – Organisation of maintenance of national roads

### **Ministry of Agriculture**

14.08.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Agriculture for the purpose of assessment of the consolidated annual report 2005 of the state

28.04.2006 – Handling of issues related to rape and bio-diesel fuel by the Government

### **Ministry of Finance**

29.09.2006 – State support to local governments in developing the information society

29.08.2006 – Audit report of the National Audit Office on the consolidated annual report 2005 of the state

20.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Finance for the purpose of assessing the consolidated annual report 2005 of the state

30.05.2006 – Organisation of tax audits

24.03.2006 – The activity of the Ministry of Finance in accrediting the Intermediate Bodies and Final Beneficiaries

### **Ministry of the Interior**

06.11.2006 – Accounting land hire purchase claims and ensuring accruals

06.09.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of the Interior for the purpose of assessment of the consolidated annual report 2005 of the state

29.09.2006 – State support to local governments in developing the information society

10.04.2006 – Fire prevention in residential buildings

03.02.2006 – The activity of the Ministry of Internal Affairs in administration of buildings belonging to the state

### **Ministry of Social Affairs**

07.11.2006 – Effectiveness of organisation of medical rehabilitation

14.09.2006 – European Social Fund measure 1.3 “Equal opportunities in the labour market”

11.09.2006 – Outsourcing services for rehabilitation of people with special needs from the state budget

24.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Social Affairs for the purpose of assessment of the consolidated annual report 2005 of the state

28.03.2006 – The use of money allocated from state budget to local governments for paying subsistence benefits

### **Ministry of Foreign Affairs**

16.06.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the Ministry of Foreign Affairs for the purpose of assessment of the aggregate annual report 2005 of the state

15.02.2006 – Organisation of accounting and legality of transactions of the Estonian Embassy in Brussels and the Permanent Representation of the Republic of Estonia to the EU

23.01.2006 – Implementation of public procurement in the Ministry of Foreign Affairs

### **Local governments**

15.06.2006 – European Commission Assistance Project HASCO in Sonda Rural Municipality

31.07.2006 – Structure of internal control system, organisation of accounting (incl. disclosure of financial information) and legality of transactions in the Rural Municipality of Saare in 2004 and 2005

09.08.2006 – Structure of internal control system, organisation of accounting (incl. disclosure of financial information) and legality of transactions in the Rural Municipality of Vormsi in 2004 and 2005

29.08.2006 – Structure of internal control system, organisation of accounting (incl. disclosure of financial information) and legality of transactions in the Rural Municipality of Rakke in 2004 and 2005

29.09.2006 – State support to local governments in developing the information society

24.10.2006 – Organisation of the internal control system and accounting and the legality of the economic transactions in the Rural Municipality of Toila in 2004 and 2005

29.11.2006 – Organisation of the internal control system and accounting and the legality of the economic transactions in the City of Paldiski in 2004 and 2005

29.11.2006 – Organisation of the internal control system and accounting and the legality of the economic transactions in the City of Kuressaare in 2004 and 2005

11.12.2006 – Organisation of the internal control system and accounting and the legality of the economic transactions in the City of Kiviõli in 2004 and 2005

### **Constitutional institutions**

11.12.2006 – Public Procurement in the Bank of Estonia

31.05.2006 – Opinion of the NAO on the annual report 2005 and the legality of transactions of the Office of the President

30.05.2006 – Opinion of the NAO on the annual report 2005 and the legality of transactions of the Chancellery of the Parliament

23.05.2006 – Opinion of the NAO on the annual report 2005 and the legality of transactions of the Office of the Chancellor of Justice

23.05.2006 – Opinion of the NAO on the annual report 2005 and the legality of transactions of the Supreme Court

20.07.2006 – Audit of the accuracy of the annual accounts 2005 and the legality of the transactions of the State Chancellery for the purpose of assessing the consolidated annual report 2005 of the state

29.09.2006 – State support to local governments in developing the information society

**Miscellaneous**

25.10.2006 – Overview of the Use and Preservation of State Assets in 2005

## 1.8. Personnel

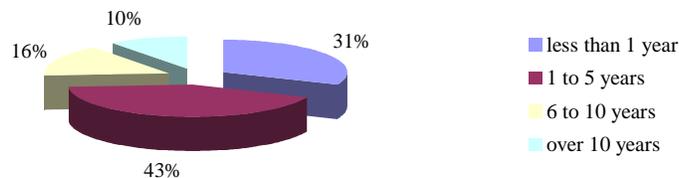
At the end of 2006, the NAO employed 96 persons, 13 persons more than at the beginning of the year. The personnel has increased first and foremost due to people employed by the local government audit department, established in 2006. General staff turnover during the year was 17 %.

2006 was the time for balancing in organisational activity. Main focus was on the development of auditing methods.

The highlights of human resources work during the year include successful implementation of local governments. A capacious training programme of management skills for both top and medium level managers was carried out during the year; development of assessment and training systems was started; volumes of training, incl. international training was increased. Working environment council was launched successfully, 98 % of employees used comprehensive occupational health services.

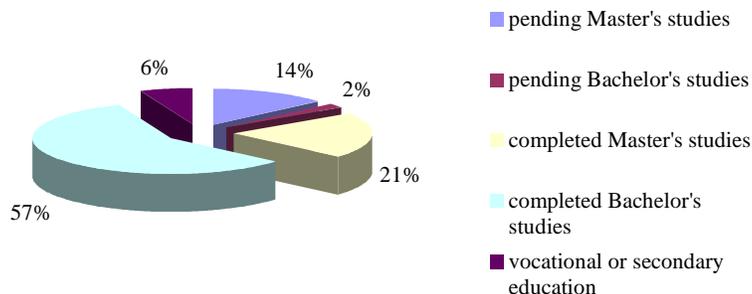
A bit more than 10 % of the NAO staff have worked here for more than ten years, and due to the establishment of the new department the share of those who have assumed office during the year and those who have served 1-5 years is quite big (31 % and 43 %, respectively).

**Figure 1.** Length of service of NAO employees as of 31.12.2006



The vast majority of NAO employees have higher education – 92 %, whereof 21 % have an academic degree. Only 6 % do not have higher education and are not in the process of acquiring it. Quite a few employees are doing academic studies to obtain Master's or Doctor's degree – as much as 14 % of the staff will soon complete such studies.

**Figure 2.** Level of education of NAO employees as of 31.12.2006



A slight change (4 %) towards the prevalence of men has occurred in the NAO's distribution of gender. As of the end of 2006, 37 % of the employees were men and 63 % women.

The average age of staff is 37 years and the age group of 21 to 30 is the largest (38 %), followed by the age group of 31 to 40 (34 %).

Kairi Kübarsepp  
Head of Personnel Service

## **1.9. Relevant aspects of the NAO's foreign relations**

Objectives and policies of and persons responsible for foreign relations were established by the management in a document "Foreign relations of the NAO" approved in July.

In the past years, the foreign relations have mostly focused on integration into the European Union, participation in the activities of INTOSAI and EUROSAI. The NAO's representatives began work in two subcommittees to the INTOSAI Capacity Building Committee. In addition to close professional relations with the European Union colleagues, the NAO began participating in a more active manner in the activities of supreme audit institutions of third countries in 2006.

At the beginning of the year, the NAO was visited by a delegation of Moldovan Court of Audit led by Ala Popescu, Chairwoman of the Court of Audit, who became acquainted with our experience in becoming a modern public sector audit organisation. Further development cooperation was agreed upon. The NAO was also visited by Rasa Budbergyte, General Auditor of the National Audit Office of Lithuania, Susan Westin, Head of Board of Auditors for NATO, Andrey Vasiliev, Chairman of the Court of Auditors for Leningrad Oblast and delegation of auditors, delegation of Constitutional Committees and Legal Affairs Committees of the Parliament of Georgia and delegation of the national anti-corruption committee of Macedonia.

In September, the NAO, SIGMA and European Court of Auditors organised a final seminar in Laulasmaa of the working group for auditing methods and manuals of new European Union members and countries applying for membership, where there were participants from 16 countries. Summaries were drawn up of the working group's efficient work of seven years.

The Auditor General acted as head of delegations in international seminars in Kazakhstan and the Ukraine, which celebrated the 10<sup>th</sup> anniversaries of the courts of auditors of said countries, and in December he participated in the conference of EUROSAI – ARABOSAI in Tunisia and in the meeting of the liaison committee of the supreme audit institutions of the EU Member States and heads of the European Court of Auditors in Warsaw.

An important event was the visit of NAO's delegation to the Court of Auditors of Russian Federation, where the heads of supreme audit institutions of neighbouring countries signed a Memorandum of Understanding on the cooperation of the NAO and the Court of Auditors of Russian Federation. For its realisation, the NAO began making preparations for the joint analysis of the implementation of agreements of economy of the two countries in the areas of transport and energy. Main topics of discussion at the annual meeting of the representatives of the supreme audit institutions of Baltic Republics, Nordic Countries and Poland held in Jurmala included ensuring the quality of audit and auditing of consolidated financial reports and local governments. In the framework of the cooperation of the Baltic Republics, a joint meeting of the representatives of audit committees, state audit offices and Ministries of Finance of the three countries was held in Vilnius, where experience gained from cooperation and best practice were introduced.

In addition to longer international training courses in various areas of audit in India and National Audit Office of the United Kingdom, the NAO participated in shorter training seminars of EUROSAI and other seminars, including in events organised by several committees and working groups. In addition to the Capacity Building Committee, the NAO participates in the INTOSAI working group for environmental audit and privatisation audit. In the subcommittee of instructions for financial audit of the INTOSAI Auditing Standards Committee, the NAO is represented by several so-called back-office experts, whose duty it is to help the experts specify the characteristics of implementing international auditing standards in the public sector. The NAO is also a member of the EUROSAI Environmental Audit and Information Technology Audit Working Groups and continues its activities in the EU

Financial Management Working Group with the purpose to prepare an overview for the Parliament of the administration and use of the EU funds.

In 2006, the NAO adopted an important decision to apply for the position of the head of the INTOSAI Environmental Audit Working Group as of 2008, when the team of the Canadian National Audit Office retires from office. The Auditor General gave an overview of his vision on finding solutions to future tasks in the meeting of the INTOSAI Environmental Audit Working Group in Vancouver, where the candidacy of the NAO was approved unanimously.

Rein Söörd  
Head of International Relations Service

## 1.10. Overview of relevant economic indicators

(EEK thousand)

	2006	2005	2004	2003
<b>Balance sheet indicators</b>				
Varad aasta lõpus	22 988	22 656	23 621	22 550
Liabilities at the end of year	2 545	1 266	1 064	1 038
Net assets belonging to state budget at the end of year	20 443	21 390	22 557	21 512
<b>Income statement indicators</b>				
Operational revenue	333	12	50	
Operating expenditure	50 327	35 431	33 759	
Operating result	49 994	35 419	33 709	
Financial revenue and expenditure	X	X	3	
<b>Other indicators</b>				
Average number of employees (persons full-time equivalent)	94	78	81	
<b>Budget and its implementation indicators</b>				
Eelarve tulude maht	0	0	0	
Implementation of budget revenue	333	12	50	
Volume of budget expenses	49 070	35 516	34 008	
Implementation of budget expenses	49 058	33 953	33 999	

The amount of assets increased in 2004, as the ventilation and cooling system the construction of which had already started in 2003, was registered as fixed assets.

Decrease in assets in 2005 is due a rise in the limit for acquisition cost of the assets registered as fixed assets from EEK 10 0000 to EEK 30 000.

Increase in assets in 2006 was mostly due to the acquisition of TeamMate auditing software.

Percentage of all commitments of the commitment for holiday pay to be paid at the end of year was as follows:

79 % in 2003

68 % in 2004

88 % in 2005

78 % in 2006

There was an increase in liabilities in 2006 due to the establishment of a new department (local government), the number of employees increased and holiday commitments to be paid increased, resulting in a debt (EEK 417,000) for the TeamMate auditing software.

The difference between the report on the implementation of the NAO budget and the income statement is the result of the fact that the report on the implementation of the budget is based on accrued expenses, whereas the income statement relies on cash-based expenses.

The NAO does not usually enter revenue in the budget.

The revenue was made up by:

In 2004, insurance benefit accrued from the loss adjuster of IF Kindlustus for the elimination of a water accident in an office building

In 2005, non-monetary targeted financing of training expenses

In 2006, support from the State Chancellery in the framework of measure 1.4 project „Improving Administrative Capacity“

## 1.11. Report form for the implementation of activity plan for 2006

Area of activity/ measure	2006 prescribed budget expenses	2006 actual expenses	2006 financing transactions prescribed in budget	2006 actual financing transactions	2006 prescribed budget revenue	2006 actual revenue	Explanations on the over- or under-implementation of the measure's budget
<b>Total NAO's area of government</b>	<b>49 070 271</b>	<b>49 379 208</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>333 158</b>	<b>Planned budget does not recognise the sums transferred in 2005 and study loans from which expenses were made in 2006.</b>
<b>Total economic control</b>	<b>49 070 271</b>	<b>49 379 208</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>333 158</b>	

### Strategic objectives for 2006–2008 and their target levels for 2006

Our objective divided into ten:

1. Provide as complete, systematic and independent information as possible for the members of Parliament on the use of state funds and assets.
2. State's financial account is in order and accurate.
3. Internal control system of the public sector guarantees that the activities of the authority are lawful and sustainable.
4. Information systems of the state ensure the timely provision of necessary information for decision-making or providing services for an individual.
5. Planning of state budget is based on the long-term objectives of the activities of the state (authority) and the process of budget preparation has become stable.
6. Programmes financed by the state reach the objectives set by them with the optimal use of funds and time.
7. State participation in foundations, companies and non-profit associations is purposeful, transparent and effective.
8. The state uses accurately and in compliance with the EU requirements all potential support funds available from the EU.
9. The NAO's performance audits cover large wholesome problems and provide feedback for the Parliament.
10. Every audit must provide information directed at the future.

### Current situation

1. The NAO has prepared an overview of the use and preservation of state assets. It also prepared an audit report for the consolidated annual report of the state.
2. The state's financial accounting as a whole cannot be regarded as accurate, as an assessment was given to the consolidated annual report of the state along with comments.
3. The audit report for the consolidated annual report of the state gave an assessment on lawfulness also with comments. Additionally, most financial audits have identified bigger or smaller violations.
4. In the overview of the use and preservation of state assets, the NAO stated that coordination of the area of IT is poor and services are not directed at citizens. The NAO shall address this topic in a more thorough manner in 2007.

5. Many performance audits have revealed that there are no measured objectives assigned for areas. Budget preparation process has not become stable because the principles have been partly changed every year.
6. (also 9.) So far, none of the performance audits have given a positive assessment to the audited authority (considering the focus on problems, it is somewhat logical).
7. State participation in foundations, companies and non-profit associations was recognised in the overview of the use and preservation of state assets, a separate audit shall be completed in 2007.
8. The topic for 2007 is the audit of the use of EU funds.
9. It can be said that none of the performance audits have addressed a less relevant single issue. However, there is room for development, as the scope of the problem is not the first selection criterion (rather it is the acuteness of the problem). However, trend towards potentially wide topics can be clearly seen. In general, the committees of the Parliament have been satisfied with the reports.
10. Based on the feedback surveys conducted among the audited authorities, the NAO's recommendations are mostly relevant and can be implemented. The information provided in reports was regarded as new in less than half of the cases (at the same time it should be taken into account that the respondents were auditees who are generally well acquainted with the area and thus no information is generally new to them).

Measures							
1. Audit	49 070 271	49 057 640	0	0	0	333 158	It was decided to not use the funds for the renovation of the NAO building until a clear indication of the building's fate.
2. Study loan		321 568	0	0	0	0	

### **Overview of improving the quality of public services and development of organisation**

The NAO began auditing the local governments, launched the department addressing this topic and largely filled the positions in it.

In order to improve the quality of audit, the introduction of software for audit documentation began, and an external expert assessed the process and methods of financial audit.

Stage I of digitalisation of audit materials was launched, by the end of the project in 2008, all audit files shall be digitalised and made available to the public on the website of the NAO.

The project of examining the NAO's history was launched, digitalisation of historic materials.

Preparations started for the assumption of presidency from the Canadian National Audit Office in the INTOSAI Environmental Audit Working Group at the end of 2007.

To develop cooperation and make it more open, a system of feedback from auditees was established.

### **Explanations on used methods**

The expenditure budget for the measure "Audit" covers the expenses of activities directly related to the measure and expenses indirectly related to them (support services), except for study loans written off from the state budget and taxes paid on them. Expenses relating to study loans are recognised in the measure "Study loan".

## 2. Auditor General's speech and response to the questions of a member of the Parliament as well as published articles in 2006

### **Speech of Auditor General, Mihkel Oviir, to the Parliament on 8 November**

#### **Distinguished President of the Parliament, fine Members of Parliament,**

World media has mediated messages on the Government of Hungary, where it is said that the Government led by the Prime Minister have lied to the public in several years about the actual economic problems of the state; to preserve power, the Government has fed populist promises to people; just vegetated, without daring to carry out necessary reforms in the social area, public administration and other areas.

Naturally, the same question shall be asked over here. How are things in Estonia? Is the Estonian Government lying?

I am glad to assure the Parliament and the public that the Estonian Government has largely spoken the truth in its report on the previous financial year.

The financial situation of the state is good and has been improving continuously. The state has sufficient funds to cover all existing liabilities. Accrual of revenue has improved. Expenses have been made in the prescribed volume.

These conclusions would be impossible without the consolidated annual report 2005 of the state, which deserves some recognition. Today, this report is waiting for your approval as the next item on the agenda.

Irrespective of the comments made by the NAO, it can be said that the consolidated report submitted by the Government is gives a better overview and is more informative than in previous years. However, without doubt, there is still much room for development.

First, the report should be submitted in spring. It is already 8 November 2006, you shall approve the 2007 budget very soon. And yet the report put before today you is for the year 2005.

This raises a question – can the Parliament use this information in a useful manner? It does not seem so. Furthermore, the report has been submitted in a manner that needs special knowledge for understanding.

Reporting in Estonia can be hastened and made more reasonable. For this, the number of independent accounting units should be reduced.

The consolidated report of the state covers the indicators of almost 1,700 units, local governments form a vast majority of them. Independent accounting is often maintained at the level of school, nursery school, etc. This is not reasonable.

The organisation of accounting in Great Britain could serve as an example, with less than 1,300 accounting entities being consolidated into the annual report of the state.

Likewise, Scotland that can in some way be compared to Estonia, provides a good example. The number of accounting units over there is only about 200. We have almost nine times that amount!

However, a solution for the local governments is also required in order to achieve significant improvements in the quality of data and transfer speeds. The state could provide them a possibility for centralised accounting.

My conviction has been clearly supported by audits performed by the NAO in local governments since the beginning of this year. We have identified many errors but these have not been the result of direct malicious activity.

90 % of the local governments in Estonia are very small. They have a hard time finding and keeping accountants, information technology experts, lawyers and other specialists with good professional training. There are not many of such people and there is no point in being angry at local governments because of the lack of these people because there will probably be none.

And as long as we have a country full of thimble-sized rural municipalities, the state should provide support for them in the normal implementation of certain functions. Because if a piece of music has been written for a symphonic orchestra, it can not be played with only a zither and a comb and paper.

### **Honourable Parliament,**

State budget is a joint treasury collected in the result of the work of all taxpayers. And allocation of funds from said treasury should serve clear purposes. Thus, the first sentence of the consolidated annual report of the state is very accurate.

I quote: “One of the principles for good public administration is that specific objectives are set for the use of state funds, the compliance with which could be measured later.” End of quote. However, the paradox lies in the fact that it does not become evident from the consolidated report whether the objectives set for the year have been met. The report does not give an overview of the performance of activities.

The fact that every kroon should be valued has become very important in my eyes in present-day Estonia. In a situation where the amount of money increases we should not give in to the temptation to distribute it extensively. On the contrary, we should consider very carefully how we could offer more with the existing amount.

### **Dear audience, fellow taxpayers!**

In the near future there will be discussions on how to improve life in Estonia and reasonably use the taxpayer’s money, thus I shall list some areas that are worth discussing seriously so as to handle the taxpayer’s money in as reasonable manner as possible.

Furthermore, I suggest you abandon current perceptions in the discussions and let your thoughts roam freely, however radical it may seem to you.

In relation with medicine, for instance, all we hear is that this area needs more money. It is probably really needed for something. But I call on you to think of what we could do better with the existing funds.

For instance, is our hospital system reasonable? Maybe it would be reasonable to provide complicated inpatient treatment in three or four large hospitals, where top specialists, operating sections and other equipment work 24 hours a day – in three shifts, providing the maximum level of occupation and effectiveness?

As a balancing factor, outpatient service would be available also in smaller centres all over the country.

The need for the nursing care service shall probably increase too, because our population is ageing. It might be possible to partly alleviate this problem by reorganising existing small hospitals, and partly by entry into the market of new service providers?

When addressing all these issues that need discussing we can not close our eyes to the fact that the number of workers, including medical staff, decreases. Read our audit report on this topic.

And we must decide, otherwise real life shall make decisions for us. When we miss the right time, we lose the chance to influence processes.

Relying on these facts, we have only one more important choice to make – whether to endlessly allocate money for fighting the consequences, or start to fight the causes.

In other words – is it reasonable to continue contributing to treatment, or would it be reasonable to contribute to the fact that people would be healthier and would not need as much treatment.

I believe that the time is not far when taxpayers taking care of their health shall ask – why do I have to pay for the treatment of a person who drinks, smokes and ignores the rules of healthy lifestyle.

I see the important are of work for the state in promoting healthy lifestyles, healthy nutrition of body and mind. This brings back and, all in all, helps to save the taxpayers' money and the most expensive resource of all – people. This is our future direction.

In addition to contributing to taking care of health, everyone in Estonia should contribute more to preventing potential accidents. For example, let's take fire accidents. By the proportion of fires and people killed by fire, Estonia is currently in the worst state in the European Union.

Last year, the number of people killed by fire was more than six times the amount per 100,000 inhabitants than in Finland. The number of fires in Estonia per 100,000 was more than three times the amount in Finland. More than 700 persons have been killed by fire in Estonia during last five years.

In my opinion, the problem in Estonia does not rise from the lack of officials of the rescue service, but from the fact that irresponsible people create far too much work for them, meaning that there are far too many fires in Estonia.

Here, the people's own responsibility plays a big part. Once again, more attention should be drawn to prevention, so that it would be possible to focus less on reaction. This is all related to taxpayers' money. Thus – complaining about the state is not sufficiently justified, because every person must be responsible for something.

However, the state should use the levers in a stricter and more systematic manner, so as to direct the citizens to the path of reasonable behaviour.

For instance, the number of people that could form almost two Parliaments is killed in traffic accidents in Estonia every year. Yes, fortunately, it is more than twice less than 15 years ago, when nearly 500 were killed each year. But let us not forget those thousands that become crippled in traffic and accidents at work.

We must set clearer objectives for improving the quality of human life and finance the compliance with said objectives. Our objective should be to decrease the number of people killed or injured by X figure or per cent, compared to the situation today. We must set measurable objectives. The word "indicator" does not sound badly if it is used reasonably.

### **Dear audience,**

Now back to evergreen topics. Every year, standing in front of you, I must mention that the state does still not have a clear real estate policy. All we see is that its completion is continuously put off, the Ministry of Finance's next deadline is in February. You all know very well what it means.

This year, the NAO observed more thoroughly how the state rents premises for itself from outside. It became evident that state authorities have rented more than 270,000 square metres of buildings and rooms from companies.

This area put together is more than 11 new art museums with all rooms and halls. 60 % of it is rented from the Riigi Kinnisvara AS, owned by the state, and 40 % from the companies of so-called real private sector.

Absence of a clear real estate policy has resulted in the fact that office premises are rented from the real private sector for ten years or even a longer period, sometimes with a guaranteed lease period of years. This complicates the cancellation of contract if needs should change.

Such behaviour is especially hard to understand when talking about leasing rooms to an authority related to the permanent functions of the state, such as security, area of rescue.

When these lease contracts expire, new premises have to be found or continue renting the current premises under the terms and conditions of the lessor. If we ourselves had invested in real estate, the buildings would also be in our possession.

We should look at things in a long-term perspective. In general, we should avoid a situation, where premises are rented for the discharge of permanent functions, instead of building or buying.

However, if the premises are needed for a shorter time, it may be reasonable to rent them from the private sector instead of building them yourself. Every case should be regarded separately.

I shall not retell you the so-called Kalevi and Police building case, this is thoroughly described in the written overview presented to you. But a lot can be learned from this case for the future.

This means that all such processes have to be transparent, they should have a beginning and an end. For example, it should be clear who is responsible for the initiation, who worded the need and how. Who, and on the basis of what, decided that something should be done in one way and not another?

It is clear that businessmen are interested in the contract that is the most useful for them in a long-term perspective. But here, the state should not forget about the protection of its interests if it wishes to be a partner that can be taken seriously.

There are cases where the premises shall be acquired first and only then the development plan for the authority shall be drawn up.

An expressive example here is the Estonian Public Service Academy, whose development plan still remains unprepared. But that did not keep the Minister of the Interior from applying for a permit from the Government to conclude another lease contract. Thus, the state would have entered into a long-term lease commitment, the need for and prudence of it would have become clear only later.

This expenditure was cancelled, but the relocation of the Estonian Public Service Academy into updated premises is still on the agenda. Perhaps it would be reasonable to relocate into the lot of Kalev, perhaps not. A decision can only be made on this topic when all options have been analysed and the vision has become clear.

### **Dear audience!**

One of the permanent concerns of the NAO deals with horizontal cooperation. In Estonia, such problems are amplified, especially where co-operation is required from Ministries the heads of which belong to different political parties.

Last autumn I said that the so-called 11 kingdoms effect is increasingly spreading – individual Ministries conduct business as they see fit and do not tolerate anyone entering their playground.

We saw its fruits in spring in relation with marine pollution. By the way, the national pollution abatement plan that was supposed to be prepared by the Ministry of the Interior already a year ago, is still not in existence. We also saw the Ministries' fight over the surplus stock fee act and it has continued like this.

In Estonia, we avoid putting the word “responsibility” in writing upon adopting decisions. But we talk about coordinator, general coordinator and so on.

What does it mean?

Mostly, it means that we point at each other and necessary decisions are not adopted or implemented as no one feels they are responsible for it.

A distinguished manager of one of Estonia's larger companies recently mentioned in a seminar that all employees who talk about coordination instead of responsibility is sent back from his doorstep. We need definite persons responsible for activities.

So, for example, no one felt responsible for fulfilling the two objective set by the Parliament – reach the rate of 2 % for biofuels in the area of transport by the end of 2005.

None of the ministries (the Ministry of Economic Affairs and Communications, the Ministry of Environment, the Ministry of Agriculture) agreed to take the responsibility for achieving the objective.

They rather explained why the ministry in question should not manage the process.

I hope that the tasks and a clear responsible person shall be assigned for the biofuels programme submitted to the Government by the Ministry of Agriculture in December.

At the same time, everyone wishes to build his own principality, everyone develops his own program for the administration of documents, purchases his own means of flying, creates his own registers, invents his own bicycle.

In form, we sort of have an e-state. In reality, you see how people are herded around in a most frustrating manner, instead of using the data and information technology in the possession of the state.

In e-state, all provided services and movement of information should be reviewed and necessary amendments made. But who shall be responsible for it?

**Honourable Parliament,**

My experience shows that things start to function when a specific person has been appointed to be responsible with everything he's got, figuratively speaking.

Here, the organisation of the Estonian government system is also very important, precisely – clear differentiation between political and administrative levels. The responsibility of the Chancellor and of the Minister should be established very precisely.

With us, this responsibility is very different by Ministries, and dependent on persons. In my opinion, the Ministers as well as the Government as a whole, are actually overburdened with all sorts of administration and odds and ends.

We should let the Ministers create visions and make policies and the officials administer and take responsibility for the use and accounting of funds.

The case that got the attention of the Land Board, can also refer to a substantial problem in the system of responsibility and supervision.

A duty has been imposed on the Minister of the Environment to decide on the exchange of land. However, it is evident that the Minister can not delve into the contents of each case. I apologise, if Villu Reiljan could do it.

The Ministers should be relieved of signing papers and making decisions if they cannot be responsible for their contents. It is especially topical in cases where there is an office in the Ministry's area of government.

Offices are states within state, the Ministries are not competent enough or do not have the strength to perform supervision over them.

A curiosity of its own is the wrangle between the Ministry of Defence and Headquarters of the Defence Forces that has been going on for years and where the Ministry of Defence has not managed to put its foot down.

Having spent a long time as the Secretary General for the Ministry of Justice, I cannot imagine a situation where the head of the Prison Board would have gone and filed a complaint for the Minister of Justice.

The Ministry of Defence is clearly responsible for defence policy and all area of defence before the Parliament and thus also in the eyes of the people. The Ministry of Defence must become clearly aware of this responsibility and strongly interfere, if necessary.

Otherwise, there may not be an end to embarrassing situations as that related to this year's sea parade, where the expenses exceeded the prescribed expenses by several times and funds were looked for retroactively. Or a situation, where in a subunit of the military, the funds allocated for the year's wages have been spent by September.

### **Ladies and Gentlemen,**

The aim of the NAO is to help the state to be a good manager. The independent information provided by the NAO helps the Parliament to enhance the efficiency of the parliamentary control.

Currently, the partner of the NAO here in the Parliament is the Budget Audit Committee, in the status of a special committee.

European top experts in the area of audit have prepared a report on the National Audit Office of Estonia, where they emphasise that the Audit Committee of the Parliament needs more weight and reliability. To this end, the experts recommend making the current special committee a permanent audit committee.

Increasing the significance of the work of the audit committee of the Parliament would help to demonstrate to the public the actual work of the parliament and reduce the number of people who are sceptical about the parliament.

It is a specific opportunity available to the audit committee to become the main driving force in the actual protection of the taxpayers' interests by the Parliament. This is common practice in Europe and both Lithuania and Latvia have followed down that road. Unfortunately, it is not yet the case in Estonia.

The fact that the NAO's audit reports are worth reading was also confirmed in the press last week by businessman Rein Kilk who, as you remember, bought the Werol factory, where nearly 200 billion kroons of all of our money is buried.

Kilk said, and I quote: "For me, the report of the NAO was a crib sheet for privatisation. I realised that if I will avoid the mistakes described in the report, the company shall make a profit in no time." End of quote.

**Dear audience,**

TV journalist Urmas Ott usually ends his shows saying that in the next show there will be another person sitting opposite him and the discussion will be a completely different one.

I do not know if there will be other people sitting here in front of me one year from now, but I can say from previous experience that the discussion will not definitely be a different one.

I thank the composition of the Parliament ending its term of office for a pleasant cooperation!

Thank you!

And many happy meetings with voters!

## **Auditor General's reply to written questions of Mark Soosaar, Member of Parliament, concerning the transfer of a building at Esplanaadi 10 in Pärnu along with the state's investments in it**

**Mark Soosaar, Member of Parliament, submitted the following written questions to the Auditor General:**

1. How to justify the transfer of state investments without liabilities made for the construction of Pärnu Museum of New Art , so that the Museum of Art could exist in the same registered immovable after 1 September 2007?
2. Is it not about needless spending of the funds spent by the state?

To respond to the submitted questions I acquainted myself with the documents appended to the letter, I also asked the Ministry of Culture and Cultural Endowment of Estonia to provide materials concerning the allocation of investments for the Pärnu Museum of New Art.

With the commercial lease contract concluded in 01.09.1992 the Office of Pärnu City Government commercially lease a building complex at Esplanaadi 10 in Pärnu to AS Chaplin for free for the period of 15 years. Pursuant to point 3.2.3 of the contract, the tenant had to, upon the expiry of contract or its termination before the prescribed time, restitute the property to the lessor of property in the same state he received said property, taking into account normal wear and tear. Pursuant to point 4.1.2 of the contract, the lessor has a right to transfer leased property in a condition that the right to transfer leased property derives from the legislation valid in the Republic of Estonia. Pursuant to point 4.2.2 of the contract, the tenant has a right to apply for a complete purchase of leased property under established procedure. The contract (p. 4.2.8) provides for the tenant's right to use the preferential right to renew the contract upon the expiry of the term of contract in the condition that he has complied with the terms and conditions of the commercial lease contract in required manner.

According to Pärnu City Government, there were 41 tenants in the building as of November 2005, among these the largest area was used by SA Pärnu Museum of New Art, who uses the premises for free.

With the decision of Pärnu City Government of 16.02.2006, it was decided to transfer the registered immovable at Esplanaadi 10 by written public auction, the special condition of the contract of sale was that the said registered immovable is burdened with a commercial lease contract.

The state through the Ministry of Culture and Cultural Endowment of Estonia as a legal person governed by public law have supported the development of Pärnu Museum of New Art as follows:

1. The agreement of targeted scholarship concluded between Cultural Endowment of Estonia and Pärnu Museum of New Art in 1998 provided for the allocation of EEK 38,000 for ordering the draft project. In 15.12.1998, the Museum has presented a report on the purposeful use of the received funds.
2. Pursuant to Regulation No. 58 of the Government of the Republic of 14.02.2001, the investments allocated in 2001 state budget for the budgets of rural municipalities and cities were distributed, pursuant to the added distribution the City of Pärnu received EEK 1,000,000 for the Museum of New Art. The Regulation of the Government of the Republic provided that the regional treasury shall make a transfer to the builder by contract on the basis of the local government's payment order. Valid legislation did not prescribe for concluding agreements with recipients of investments allocated from the state budget, which would establish the more precise terms and conditions as well as responsibility of the use of investment.
3. Pursuant to the agreement on the use of appropriation from the state budget, concluded between the Ministry of Culture and Pärnu City Government in 08.03.2005, EEK 500,000

were allocated for the construction work of Pärnu Museum of New Art. Pursuant to the contract, the recipient of the appropriation agreed to use the appropriation purposefully and upon failure to use the appropriation or using it for the purpose or terms not established by the contract, repay the appropriation in full. According to the report submitted by Pärnu City Government, EEK 255,000 of the appropriation from the state budget was used on design work in 2005. According to the explanations provided in the letter of the person submitting the question, this comprised preparation of working drawings and stage II of technical project of reconstruction the building at Esplanaadi 10 to be an art museum. According to the data received from the Ministry of Culture, the rest of the funds were used in 2006, but if the museum should be relocated from Pärnu, the Ministry explained that the unused funds shall not be paid to Pärnu City Government.

**On the basis of the above, my points of view are as follows:**

- City of Pärnu as the owner of the property has a right to decide on the disposal of its assets, incl. its transfer, under the procedure established by the council. In the case of transfer of assets, the concluded commercial lease contracts shall remain valid. Possibility for the transfer of rented assets was also provided in the commercial lease contract concluded in 1992.
- I do not consider it possible or necessary to assess the purposeful use of funds allocated by the state for the reconstruction of the building at Esplanaadi 10 in 2001. The Museum has had the possibility for several years after construction work to operate in the building and the mentioned investment may be depreciated by now.
- If the project for reconstruction of the building at Esplanaadi 10, completed for state 's money in 2005, remains unused, the use of state funds has been needless. However, as the funds (investments) allocated by the Ministry of Culture and Cultural Endowment of Estonia in 2005 have been used purposefully, according to reports, as the promised design work has been completed, the legislation and concluded agreements do not provide for the possibility of reclaiming the spent sums. I would like to add that the NAO currently audits the use of investments allocated to local governments from the state fund and considers submitting motions to amend legislation or the form of agreement concluded with the recipient of appropriation, so as to specify the opportunities for reclaiming the allocated funds.
- Upon deciding on investments, the Ministry of Culture should have paid attention to the fact that the Museum operates as a lessee and the concluded commercial lease contract shall expire soon. Although the 1999–2005 Development Plan for the City of Pärnu prescribed the renovation of the building at Esplanaadi 10 and the new 2006–2015 development plan prescribes the construction of Pärnu Museum of New Art (without mentioning a specific address), the Ministry should have been sure that the Museum shall still be operating after the year 2007 in the premises which the investment was applied and allocated for. Current result is that state funds have been allocated for a building (preparation of project), the further use of which as a museum is not certain.

**I would like to give brief responses to submitted questions:**

1. I shall not form an opinion on the justification of the decision of Pärnu Council regarding the transfer of the registered immovable at Esplanaadi 10. Local government as the owner of the property shall decide independently on the issues related to its assets.
2. The state must thoroughly consider the objects for which it shall allocate investments from the state budget. I share your concern that this has currently not been done in a sufficient manner. Local government's right to freely use and dispose of its assets should not lead to the unreasonable use of state investments. Upon allocation of state investments to local governments, the state should take measures which would ensure that the actual objective of the investment shall be met or, if that does not happen, the investments shall be returned to the state. If the project for state II of reconstruction of the building at Esplanaadi 10,

completed for state's money, remains unused, EEK 255,000 paid for the project have been spent needlessly.

## **On the back of the tiger, the benefit of e-state must reach everyone**

Mihkel Oviir writes that Estonia could be considered successful in the development of information society, but also reminds that IT is not an objective but means for bringing the state closer to people. If the state does not address this issue, the tiger loses its ability to leap.

\* \* \*

Most of us have probably complained when dealing with the state or local government that people are herded from one authority to another – collect approvals for an applications, receive documentation. Data printed on paper from the electronic system of one authority has to be taken into another, where it will in turn be entered into a computer program. This is extremely slow and characteristic of a paper state, or P-state not E-state.

For example, in this late spring, Tallinn City Government demanded that citizens who wished to purchase free land bordering their registered immovable, would submit an application on paper and accompany it with the copy of their passport and extract from the land register. Yet, the information given in these documents is available in the central databases of the state. Why the citizen had to resubmit all data already known to the state and bother himself with making a copy of the passport and obtaining an extract from the land register?

The purpose of this example is not to reproach the City of Tallinn whose level of IT is one of the best in Estonia. It is just an example of a situation of how the actual IT-opportunities of the state are not used for the benefit of citizens. Estonia is technically ready to provide a very good service but it gets stuck in the officials’ convenience and wrong way of thinking, the last piece of the bridge that would lead e-service to the citizen is still missing.

This is also confirmed by a recent audit of the NAO, performed in cooperation of E-Governance Academy. The audit addresses the state support provided to local governments upon the development of information society, it also examined the opportunities of people in rural and urban areas and their wishes to use the benefits of information society.

Yes, Estonia can consider itself very successful in the development of information society. Not only because we have managed to give this impression for the rest of the world with our successful initiatives: we already have a million ID cards, e-elections, bringing libraries online, public access points to the Internet, public WiFi, etc.

The signs of success comprise also the amount of people using computers and the Internet – 60 % of inhabitants according to the survey of Emor carried out this spring – and a fixed position of online banking in our everyday life. Another significant fact is that this year, over 80 % of people submitting the income tax return completed it online and overpaid sums were returned to the people who submitted the income tax return online within five days. Here, Estonia is an example for the entire world. But ...

### **Digital gap widens**

The NAO still worries because in our opinion the state should take significant and strong steps in order to prevent our tiger from turning into a lazy lounging animal and keep up the current development rate. We should keep in mind what has been mentioned in the European Union information society document i2010: approximately a quarter of the growth of the Union’s gross domestic product and 40 % of the increase in productivity is due to the implementation of information and communication technology.

Although the number of owners of computers and Internet-users has increased in Estonia over the past five years, the digital gap between urban and rural households continues to grow. In terms of Internet connection in urban homes, Estonia is near the average of the EU countries. The number of connections in our rural homes, however, is one third less than in the city.

In North-Estonia, 49 % of homes have a computer and 44 % have connection to the Internet, in North-East Estonia, however, the respective numbers are only 30 % and 24 %. At the same time, nearly 40 % of households considers it too expensive to buy a computer and acquire an Internet connection, or doubts its purposefulness.

This is due to the costs accompanying the establishment of Internet connection, over 60 % of households without connection considers them too high, as well as technical difficulties with data communication in low density areas.

The situation should improve significantly after implementation of the “KülaTee 3” project launched in the preceding year aimed at providing Internet connection to rural population. The state allocated 30 million kroons for that purpose. By the end of the project, direct connection to the Internet should be available in almost all rural areas on the conditions specified by the state.

According to the Eurostat, the statistical office of the European Union, more than one third (37 % or about 370,000 people) of Estonia’s 15–74 year old population does not know how to use the computer, more than 100,000 of them would learn it with the support from the state.

Thus, we have a lot to improve in our general level of computer skills, to catch up with the Nordic Countries where almost nine people out of ten can already use the computer in a minimum level. Estonia with its two thirds is on the average level of the EU but that should not satisfy the ambitious e-tiger.

Therefore, the NAO made a recommendation to the Minister of Education and Research to organise in cooperation with local governments a free training for computer and Internet skills for 20,000–30,000 people a year in the period of 2007–2010.

At the same time, Internet connection and computer skills do not automatically reduce the gap between urban and rural households. The usefulness to people of e-services provided on the Internet shall become decisive as well as people’s ability to handle things over the Internet. The third factor is the expenditure accompanying the Internet. The gap starts to decrease when an individual feels that the profit of Internet is larger than expenses on it.

### **Who is responsible?**

Even development of information society for all citizens shall hopefully be one of the issues that will find a place in discussions held on the future of Estonia. Also, I hope that Estonians can learn from the Brits who years ago took the management of development of e-state into the level of the office of the Prime Minister.

In the Estonian system of coalition governments and ministries, the ministers do not generally want to interfere with each others playground. There are some for whom the topic of information society is not attractive enough; and some who find that IT is a support function and should be addressed by each office separately.

Thus, we see the usual problem in Estonia – every ministry looks at the issue only from its own point of view, there is lack of initiators and responsible persons.

The Ministry of Economic Affairs and Communications addresses the information policy and development of e-state. Local governments are in the area of government of the Ministry of the Interior. But whose concern are the development of local information society, addressing the local

governments' needs for information technology and problems? Unfortunately, the local governments' own concern.

At the same time, local governments provide an estimate of 70 % of public services. Most local government authorities have been able to acquire modern computers and have a reliable Internet connection.

However, it has not always been considered that the information technology solutions should be compliant with the national information systems in order to publish as much of the activities of the local governments through these solutions as possible and that the solutions should enable the citizens to use as many of the services provided by the cities and rural municipalities as possible through the Internet.

So it must be admitted that most local governments in Estonia are not capable of handling independently all the information technology tasks before them as well as duties imposed by the state. Only in local governments can you return a form downloaded from the website, after completing and digitally signing it. By the way, the strong leader among local governments is Tartu City Government who, in the course of the audit, could offer 14 types of proceedings in digital form.

There is a lack of IT specialists in rural areas, most local governments work separately, without coordinating their activities with the others. The state has tried to justify its relative inactivity in the area of local governments by stating that intervention would violate the local governments' principle of independence. Local governments disagree. On the contrary – national local government associations are of the opinion that state support and coordinated cooperation for the support of local governments is necessary.

### **IT is means, not objective**

Logic of development of information society, e-services and e-governance should make us realise that IT is not an objective on its own but means and opportunity to make the use of public services simpler, faster, more efficient, more convenient and better for the citizen.

Already now the law requires the state to base the provision of public services on the fact acquisition of service of both citizens and businesses would be cheap, simple and convenient. How this requirement is complied with can be seen from each individual's own experience.

I firmly believe that citizens should stop authorities and officials from herding them around and require them to resubmit data that already exists in the state's databases. I call on everyone to protest in cases where someone will once again try to force them to handle things in a traditional P-manner – by carrying papers around and running from one official to another. It is the job of officials to gather necessary information.

There are also positive examples on the compliance with the last principle: transfer of the parental benefit and family benefit application procedure into an electronic format released more than 200,000 parents from the obligation to obtain up to seven paper documents from different authorities, while the officials were released from the duty to verify and enter the data from these documents. Unfortunately, these are still exceptional examples.

### **E-state is always there**

Recently, there have been complaints about how state authorities keep leaving rural areas, the presence of state decreases, etc. In my opinion, such complaining is based on a wrong prerequisite of how the presence of state should be indicated by the existence of a department, branch or other representation of a state authority in the centre of county. Yet, it is not the authority's physical presence that is important but the fact whether a person can solve his problems in a most convenient manner.

Yes, several state authorities have optimised their structures without mutual coordination in a way that you have to travel from Viljandi to Tartu to take care of something, to Pärnu to take care of another and to Tallinn in order to take care of a third problem.

This is confusing but there is a very simple solution to this problem. Namely the use of information technology makes it totally irrelevant where one or another authority providing public service is located.

In Estonia, things should be organised in a way that everyone could express from his home computer or local government's service point his wish to receive a public service or another. All the rest – collection of all sorts of approvals, data, etc. by using the information systems and databases of the state – is the concern of the state or local government. This would be the so-called one-window system, where an individual submits his e-application and receives the response, the result at the same place.

And the people who live in remote rural municipalities can always turn to help to their rural municipality centres if they have an activity to perform, they do not have to travel to a faraway county centre or to the capital so that officials could have them running around.

This leads to a situation where the citizen feels the presence of the state irrespective of his current location. E-state will help us provide a feeling of the presence of the state for citizens in a far more better way than through the on-the-spot existence of a representation of a state authority.

Thus, by supporting the development of people's computer skills and establishment of a cheap and available Internet connection on the one hand, and by providing a good public service electronically on the other hand, we can significantly alleviate the problems that are currently acute in rural areas.

Certainly, it does not mean that all services of the state and local governments could be made available online as of tomorrow. But we have to start somewhere. Unfortunately, there is still no analysis on which services, when and to what extent should be used electronically.

The medium tier of the European Union has already chosen 20 principal public services, which should be made available online among the first. It has also defined the four levels of the provision of e-service, from the dissemination of service-related information at the website to the fully electronic provision of the service.

Therefore, the possibility of transfer of all public services to e-services should be analysed. Upon the development of e-services the needs of potential users should definitely be examined. By making the most frequently used public services electronically available before others, the citizen gains the most. This would enable to organise the information management and exchange of the authorities in such a manner that everyone would be able to provide the agreed e-services in a couple of years already.

### **People waiting for e-service**

Research Centre Klaster identified that people both in the country and in the city are ready to use various e-services provided by the state, people have a positive attitude towards them. People think that e-services save time (86 %) and money (46 %), they help to acquire required information in a faster way (74 %), also more information and quality information (36 %) and these provide an opportunity to better reconcile family and work life (31 %).

Henn Sarv, one of Estonia's most famous promoters of information society and IT experts, has superbly worded his objective in using information technology – the objective is to help an individual with means of IT back to the nature and natural way of life. Sarv emphasises that use of the information technology provides an opportunity to save us from routine work and focus more on self-discovery, learning and being creative.

It cannot be ruled out that the thorough analysis of current public services will promise to eliminate hundreds of actions or thousands of positions upon the introduction of e-services. People shall be relieved of performing such duties that can be performed by machines: this enables to save human resources for tasks only completed by a human, so alleviating the problem of the lack of workers haunting Estonia.

Let us use these opportunities. And let us be happy that our problems are what they are – totally trivial and simply solved compared to the troubles of the rest of the world.

### **Opinion**

Henn Sarv, IT expert:

In his article, Mihkel Oviir has focused on a very important part in our IT and e-development. We have been successful but we do not use this success fully and it does not reach everybody.

Digital gap is largely due to people who communicate with the state or local government only once a year. He does not feel the need, does not see any problems, does not learn and does not put pressure on things. Those communicating with officials every day have found a long time ago the scarce but useful ways to handle things in the Internet.

I have seen the other side of e-services. Upon the registration of vehicle, I had the opportunity to use the e-service of Estonian Motor Vehicle Registration Centre and I saw how strange it was from the other side: e-forms, contracts and other people are printed on paper, the same with digital signatures, afterwards their value is zero, and further proceedings are still carried out on paper. Technology is like a façade, e- converted back to p-proceeding.

In Tartu, many proceedings have been transferred to e-services. Unfortunately, people and other local governments are not aware of it, or why the e-forms prepared in Tartu are used so little elsewhere.

I have made recommendations to direct some of project funds into publications. A little leaflet in every local government, introducing the existing services. And on paper, because e-services have to be described to people who do not use them, not to people who use the Internet anyway.

## **Allocation of money must seem fair, too**

Investments allocated to local governments from the state budget is a topic in relation to which the officials in your discussion group shake their heads in with an all-knowing expression on their faces, and politicians giggle meaningfully.

During the last months, this topic has acutely been put on the agenda again as a result of a discussion spread in the media whether there have been attempts to bribe electors by promising to allocated investment funds for them. Potential promise to allocate money was disapproved by both the Prime Minister and Chairman of the Finance Committee of the Parliament.

I as Auditor General do not have any evidence to support the attempts of bribery, but I can assure that the current system for the allocation of investments is not transparent. And that gives rise to doubts, whether justified or not. All doubts damage the state’s reliability in the eyes of citizens.

In 2005, 1.3 billion kroons was allocated along with supplementary budget for investments for local governments, in 2006, the amount was 1.2 billion kroons without the supplementary budget that was still being processed. Most of this amount (80 % in 2005 and 66 % in 2006) is formed by European support or its co-financing, allocated mainly from the budget of the Ministry of the Environment. European Union support and its co-financing is a separate topic I will not address here. The largest amount of investments aids regarding which no clear procedure can be found in laws or regulations is allocated from the budget of the Ministry of Culture.

### **How allocation really works?**

Pursuant to procedure established by the Minister of Culture, rankings in counties compiled by county governments based on the local governments’ applications form a relevant basis for the allocation of investment aids. In 2005, the Ministry of Culture supported a total of 134 cultural or sports object of local governments with the investment aid amounting to 143.7 million kroons.

What is significant here – only a quarter of the objects that received support ranked among the top in the list of the county. Further, a quarter of the objects that received funding were objects for which the county governments and local governments had submitted no applications to the Ministry of Culture in the period 2000-2005. Thus, for an incomprehensible reason, millions have been granted to objects for which rural municipalities and cities have not applied for!

This year, there was a case in Hiiumaa that no support was allocated for the sports building of Emmaste that held the second place in the county ranking, but the funds were granted to the Kärkla Music School and Kärkla cultural centre that were both way down the list and did not expect the support. Although a respective decision had been adopted in the Ministry of Culture at least in September of the previous year, Emmaste Rural Municipality only found out about it in January this year during the Minister’s visit to Hiiumaa.

How does the Ministry of Culture choose the local governments’ community cultural centres, sports facilities, stadiums, libraries, etc. it decides to allocate investment aids to? In addition to those favoured by rankings, funds are also allocated to objects considered as priorities of the Ministry, and some more are included in the investment list on the basis of the applications of larger cities.

The rest, which formed over one third in 2005, are selected in a rather interesting manner – the Ministry of Culture calls them “the objects of the Parliament”. In reality, the Parliament does not adopt decisions here. However, this list is compiled by the suggestions made by faction members of the coalition currently in power and it is not discussed or voted on in the plenary assembly of the Parliament. Thus, these decision cannot be called the decisions of the Parliament or political decisions as politics require forethought and analysis. The allocation of money is currently carried out on

random basis, no analyses have to be submitted for these objects, neither is it necessary to prove that they actually need the money.

When a group of representatives of people have compiled a list on the basis of their considerations, it will be communicated to the Ministry of Culture who is the formal performer of allocation of money through the Government. According to the Ministry of Culture, last year, the distribution list of objects was sent from the Parliament via e-mail. So it is possible to pretend that in the case of some objects funds were allocated by the Ministry of Culture, whereas the latter points to the direction of the Parliament.

Last week, in the special committee of the State Budget Audit Committee of the Parliament, the Minister of Culture stated in relation with the so-called objects of the Parliament that she shall not make any comments on it, thinking that said additions are made in the influence of a democratic process, to which one committee member exclaimed with an ironic smile: “Absolutely!” This was followed by laughter in the meeting room. Those present understood what it was about. I am sincerely looking forward to a time when the Minister’s words and the commentary to them could be regarded without severe gravity.

Unfortunately, it cannot be said that the decisions on allocation funds have become more understandable for the public. As discussed at a meeting on audit reports in that same State Budget Audit Committee, the situation has worsened in the past few years: every year there are more and more objects that receive money through the Ministry of Culture although local governments have never mentioned them in applications sent to the county governments for the compilation of ranking. While in 2000–2003 there were only a few objects like that, in 2004 their number amounted to 17 and in the 2005 budget even to 32, 22 % and 24 %, respectively, of all objects receiving support.

### **Dangers of current system**

As the Ministry and “the Parliament” randomly change county rankings and amounts applied for the objects, it is complicated for the local governments to plan construction work. Additionally, this may lead to a situation where some of the already made investments are not purposeful when looking at them retroactively. Therefore, the bases for decisions as well as the person responsible for inefficient investments are not clear about the current system for allocating support.

These dangers are not theoretical, they have already realised. Although regional balance is a relevant principle upon allocating investments, the ministry has supported the establishment of three buildings of a similar purpose in the same region. For instance, it has supported the construction of two stadiums located near each other in Järvamaa (in Türi and Paide). Türi stadium had been among the top three in the county ranking ever since 2000 and it was financed in 2001–2004. Since 2004, the Ministry started to support the stadium in Paide.

In Saaremaa, the Ministry has supported since 2004 both the construction of Kuressaare sports and health centre and Orissaare sports facility, whereas the Orissaare facility held the second place in the county ranking 2004 and first place in 2005 but Kuressaare sports centre was at 11<sup>th</sup> place in both years. In the past five years, two cultural centres in Kuressaare situated next to each other have been completely renovated and their auditoriums are used for similar events.

The NAO is of the opinion that taking the county rankings into consideration as much as possible ensures a transparent allocation of funds corresponding to local needs. If money is not allocated on the basis of the ranking, the decision should be justified to the county government and local government.

### **State’s burden on the back of the local government**

The NAO has also drawn attention to the fact that the ministries must carefully observe the financial capacity of local governments. The state does not provide full support for the objects, local governments have to add a certain amount of own resources. There is a danger that projects that are

too much to handle shall be cancelled, which is what happened to the swimming pool in the City of Loksa. The construction of the swimming pool with the contract value of 31.2 million kroons was begun in 2004 when the city's debt burden was 53 %. Naturally, they encountered problems and asked for help from the state, just like in the case of Orissaare sports facility.

In the last completed audit report, the NAO audited the investment aids of the Ministry of Culture but bases for allocations are incomprehensible in several other ministries as well. For instance, the Minister of Education and Research stated in his letter of reply to the NAO's 2004 audit of investments for general education schools that as of 2005, the sums prescribed for investments for municipal schools shall be included in the student's so-called capitation fee, but already the 2005 supplementary budget saw the return of allocations that the media had called "school protection".

The NAO has found on the basis of the results of the 2004 audit on "The Planning of Public Investments for General Education Schools and the Use of such Funds" that investment support may be allocated to non-sustainable schools, because there is no comprehensive vision of the future school network. The 2004 programme for public investments in 2004-2007 envisaged assistance to 21 schools (i.e., 15% of all schools), where in five years the number of pupils will drop below the minimum level required for opening a school. A survey among the local governments indicated that 80% of the local governments had adopted a school network development plan by 2004.

When at the end of 2004 the Government of the Republic approved the list of sustainable schools eligible for renovation funds allocated to GRE, the local governments submitted a list of almost all schools. However, it was known that the number of pupils is constantly decreasing. According to the data from the Ministry of Education and Research, already five of the "sustainable" schools in the government-approved list had been already closed by this year and a couple of schools have been reorganised this year. The forecasts indicate that in 10 years the number of general education schools in Estonia will decrease by 25-40 %. However, an investment that has been already made, gives the local government a justification to continue management of a non-sustainable school or even apply for further investments. The local governments manage nearly 90 % of the general education schools and they are not interested in closing the non-sustainable schools, because this would mean a loss of an income source for the local budget. However, the state should avoid making public investments in such schools.

### **Rules should be common and public**

From its 2005 supplementary budget, the Ministry of Social Affairs supported the family health centres of Orissaare and Vändra as well as Tallinn Children's Hospital, although the state has developed a separate system financing both the activities of family physicians and hospitals, and has included it in the legislation.

In a democratic state, allocation of funds must not only be fair but also seem fair. Estonia still has a long way to go but at least we are on the right track.

The NAO cannot, may not and will not doubt the politicians' right to adopt decisions and fulfil their political objectives. But if part of the money is not allocated on the basis of political considerations, i.e. considerations serving common interests, but on the basis of random and not at all thorough analysis, it should be publicly stated in the explanatory memorandum for the allocation. Be it for the redemption of a promise given to someone in area X, etc. There is nothing to be embarrassed about. This would certainly be a very transparent manner of allocation. If there is no other way, the second possibility is to include the principles of allocation of investment aids to local governments in legislation in order to prevent confusion, potential manipulations and wasting of taxpayer's money.

### 3. Annual Accounts of the National Audit Office

#### **Management's declaration**

The Management declares its responsibility for drawing up the annual accounts of 2006 on pages 54 to 66 and confirms to the best of its knowledge that:

- 1) the accounting policies applied in the annual accounts are in conformity with the accounting principles generally accepted in Estonia;
- 2) the annual accounts reflect the financial situation of the accounting entity, the results of its operations and its cash flows in a true and fair manner;
- 3) the National Audit Office is a going concern.

Mihkel Oviir  
Auditor General

Tõnis Saar  
Director of the NAO

30.05.2007

## Balance sheet

(in kroons)

	Note	31.12.2006	31.12.2005
<b>Assets</b>			
Current assets			
Other claims and advance payments	4	219 499	131 222
<b>Total current assets</b>		<b>219 499</b>	<b>131 222</b>
Fixed assets			
Tangible fixed assets	5	21 249 231	22 436 643
Intangible fixed assets	6	1 519 088	87 992
<b>Total fixed assets</b>		<b>22 768 319</b>	<b>22 524 635</b>
<b>Total assets</b>		<b>22 987 818</b>	<b>22 655 857</b>
<b>Liabilities</b>			
Short-term liabilities			
Arrears to suppliers	8	519 679	120 129
Arrears to employees	8	1 987 919	1 117 925
Other claims and advance payments	3, 9	37 398	27 585
<b>Total of short-term liabilities</b>		<b>2 544 996</b>	<b>1 265 639</b>
<b>Revenue accrued to the state budget</b>	11	<b>20 442 822</b>	<b>21 390 218</b>
<b>Total liabilities</b>		<b>22 987 818</b>	<b>22 655 857</b>

## Income statement

(in kroon)

	Note	2006	2005
<b>Operating revenue</b>			
Targeted financing for operating expenditure	3	333 158	12 250
<b>Total operating revenue</b>		<b>333 158</b>	<b>12 250</b>
<b>Operating expenditure</b>			
Labour costs			
Remuneration costs	13	-27 065 486	-19 036 829
Fringe benefits	13	-499 682	-459 112
Taxes and social security contributions	13	-9 387 351	-6 735 273
Total labour costs		-36 952 519	-26 231 214
Management expenses	10	-10 169 797	-6 039 114
Tax, fee and fine expenses	3	-1 746 141	-1 073 006
Depreciation of fixed assets	5, 6	-1 442 615	-2 074 994
Grants awarded	12	-12 642	-12 005
Other operating expenditure		-2 890	-1 084
<b>Total operating expenditure</b>		<b>-50 326 604</b>	<b>-35 431 417</b>
<b>Operating result</b>	11	<b>-49 993 446</b>	<b>-35 419 167</b>
<b>Result of the period before the settlements with the state budget</b>		<b>-49 993 446</b>	<b>-35 419 167</b>
<b>Net financing from the state budget</b>		<b>49 993 446</b>	<b>35 419 167</b>

# Report on budget implementation

(in kroons)

Classification	2006		2005	
	Budget	Execution	Budget	Execution
<b>Total the revenue budget</b>	<b>0</b>	<b>333 158</b>	<b>0</b>	<b>12 250</b>
<b>35 Grants received</b>	<b>0</b>	<b>333 158</b>	<b>0</b>	<b>12 250</b>
3500 Targeted financing for operating expenditure	0	333 158	0	12 250
<b>Total 2006 expenditure budget</b>	<b>49 070 271</b>	<b>47 498 894</b>	<b>35 515 971</b>	<b>33 953 348</b>
<b>4 Appropriations</b>	<b>13 300</b>	<b>12 642</b>	<b>13 000</b>	<b>12 110</b>
4500 Membership fees	13 300	12 642	13 000	12 110
<b>50 Personnel expenditure</b>	<b>36 164 300</b>	<b>35 768 769</b>	<b>25 681 800</b>	<b>25 681 800</b>
500 Remuneration	26 686 414	26 399 087	18 800 400	18 722 829
505 Fringe benefits	348 261	314 863	328 600	280 818
506 Taxes and social security contributions from the personnel expenditure	9 129 625	9 054 819	6 552 800	6 678 153
<b>55 Management expenses</b>	<b>11 535 671</b>	<b>11 571 238</b>	<b>7 154 171</b>	<b>7 154 170</b>
5500 Administration expenses	2 340 124	2 322 946	1 700 160	1 630 142
5502 Costs of commissioned research and development	1 095 036	902 744	172 521	171 701
5503 Mission expenses	1 029 698	1 016 967	731 000	722 069
5504 Training expenses	1 300 000	1 348 975	560 000	602 091
5511 Management costs of reg. immovables, buildings & rooms	2 121 913	2 165 207	1 967 300	1 987 912
5513 Vehicle maintenance expenses	496 000	467 851	285 390	283 684
5514 Information and communications technology expenses	2 418 000	2 545 567	1 099 820	1 101 885
5515 Inventory costs	514 900	610 329	621 980	640 819
5522 Medical expenses	130 000	117 536	16 000	13 867
5524 Training expenses (for third persons)	90 000	73 116	0	0
<b>60 Taxes, fees, fines</b>	<b>7 000</b>	<b>6 245</b>	<b>7 000</b>	<b>6 245</b>
6010 Land tax	7 000	6 245	7 000	6 245
<b>15 Acquisition and renovation of tangible and intangible assets</b>	<b>1 350 000</b>	<b>140 000</b>	<b>2 660 000</b>	<b>1 099 023</b>
1551 Renovation of civil engineering works	1 210 000	0	2 360 000	1 050 000
1555 Acquisition and renovation of ICT-equipment	140 000	140 000	200 000	29 958
156 Acquisition of intangible fixed assets	0	0	100 000	19 065
<b>Total budget of funds transferred from 2005</b>	<b>1 560 977</b>	<b>1 558 746</b>	<b>0</b>	<b>0</b>
1551 Renovation of civil engineering works	57 820	57 820	0	0
1555 Acquisition and renovation of ICT-equipment	170 042	170 042	0	0
156 Acquisition of intangible fixed assets	1 333 115	1 330 884	0	0

## Revenue

The NAO does not usually recognise revenue in the budget.

2006 revenue was formed by support from State Chancellery for the measure 1.4 project „Improving Administrative Capacity“

## Expenditure

Accrued expenses in 2006 were EEK 50,326,604 and cash-based expenses were EEK 49,379,208.

The difference between the report on the execution of the NAO budget and the income statement is the result of the fact that the report on the execution of the budget is based on accrued expenses, whereas the income statement relies on cash-based expenses.

In 2006, the Ministry of Finance allocated EEK 328,182 to NAO for writing off study loans, EEK 321,568 of which was used.

Mihkel Oviir  
Auditor General

## Cash-flow statement

(in kroons)

	Note	2006	2005
<b>Cash-flows from operating activities</b>			
Operating result	11	-49 993 446	-35 419 167
Adjustments			
Depreciation of fixed assets	5, 6	1 442 615	2 074 994
Total adjusted operating result		-48 550 831	-33 344 173
Net change in current assets		-88 277	-22 114
Net change in liabilities		853 784	201 380
<b>Total cash-flows from operating activities</b>		<b>-47 785 324</b>	<b>-33 164 907</b>
<b>Cash-flows from investing activities</b>			
Paid at the time of acquisition of the fixed asset	5, 6	-1 260 726	-1 087 414
<b>Total cash-flows from investing activities</b>		<b>-1 260 726</b>	<b>-1 087 414</b>
<b>Cash-flows from financing activities</b>			
Net financing from the budget	11	49 046 050	34 252 320
<b>Total cash-flows from financing activities</b>		<b>49 046 050</b>	<b>34 252 320</b>
<b>Net cash-flow</b>		<b>0</b>	<b>0</b>
<b>Cash and its equivalents as at 31.12.2003</b>		<b>0</b>	<b>0</b>
<b>Changes in cash and its equivalents</b>		<b>0</b>	<b>0</b>
<b>Cash and its equivalents as at 31.12.2004</b>		<b>0</b>	<b>0</b>
<b>Changes in cash and its equivalents</b>		<b>0</b>	<b>0</b>
<b>Cash and its equivalents as at 31.12.2005</b>		<b>0</b>	<b>0</b>

## **Notes to the annual accounts**

### **Note 1. Methods of accounting and the bases of evaluation applied in the annual accounts**

The annual accounts of the National Audit Office have been drawn up in conformity with the State Budget Act and the accounting principles generally accepted in Estonia. The generally accepted accounting principles are based on internationally acknowledged accounting policies (EU directives on accountancy, international standards of financial accounting and international standards of state accountancy) and their main requirements are established in the Accounting Act of the Republic of Estonia, which are supplemented by the guidelines issued by the Accounting Standards Board as well as the requirements set out in the general rules on state accountancy.

The annual accounts are drawn up using the cost model.

The cash flows from the core activity are drawn up using the indirect method. The cash flows from investing and financing activities are shown as gross receipts and gross payments of the accounting period.

The annual accounts are presented in Estonian kroons.

### **Assets and liabilities**

The assets and liabilities are divided into short- and long-term on the balance sheet, depending on whether their expected period of use is up to, or more than one year of the balance sheet date. Holiday pay reserve is adjusted once a year – at the end of the financial year.

### **Other claims**

Other claims on the balance sheet are recognised using the adjusted cost model. The claims in the balance sheet are recognised when the right of claim arises and they are assessed on the basis of the amounts likely to be received. Where possible, the outstanding claims of each client will be assessed separately, taking account of the information known about the client's solvency. The claims unlikely to be received are assessed in the balance sheet at the amount they are likely to be received. The claims received in the accounting period but previously written off are recognised as the reduced cost of the claims unlikely to be received in the accounting period. Claims are deemed to be uncollectible if the management finds that it is impossible to collect them. Uncollectible claims are written off.

### **Tangible and intangible fixed assets**

Tangible fixed assets are the assets whose estimated useful life is more than one year and whose acquisition cost is at least EEK 30,000. Assets with a useful life of more than one year and with an acquisition cost of less than EEK 30,000 are recognised as low-value inventory and written off at the time they are put into service.

Expenditure on reconstructions of fixed assets extending the useful life of the assets and improving their quality or performance when compared to the initial condition are capitalized on the balance sheet as fixed assets. Expenses on the repair and maintenance works to maintain the initial condition of assets are recognised under the expenditure of the accounting period at the time they incur.

Fixed assets are recognised at their acquisition cost less the accumulated depreciation and the possible devaluations resulting from the decrease in value. Two linear methods are used in the calculation of depreciation. The depreciation rate is determined individually for each fixed asset item, depending on its useful life.

Annual depreciation rates for fixed assets groups:

Buildings 2 %  
Civil engineering works 7 %  
Machinery and equipment 20 %  
ICT-equipment 33%  
Other inventory, tools and fittings

Land is not subject to depreciation.

Assets with a useful life of more than one year and with an acquisition cost of at least EEK 30,000 are recognised as intangible fixed assets. Intangible fixed assets are recognised at their acquisition cost less the accumulated depreciation and the possible devaluations resulting from the decrease in value. Intangible fixed assets are generally depreciated in 4 years using the linear method.

### **Financial and operational leases**

A rental contract in the case of which all important risks and benefits related to the ownership of the asset are transferred to the lessee is regarded as a financial lease. Other rental contracts are recognised as operational lease.

The assets leased under an operational lease contract are not recognised on the balance sheet. The payments for operational lease are recognised as expenses evenly throughout the lease term.

### **Targeted financing**

Support granted for specific purposes and related to certain terms and conditions is recognised as targeted financing. In the case of this support the provider of targeted financing controls the purposeful use of support. Targeted financing is not recognised as revenue or expenditure until it is sufficiently certain that the final recipient is in compliance with the terms of targeted financing and said financing shall take place.

Recognition of targeted financing of operating expenditure is based on the principle of conformity of revenue and expenditure (revenue from targeted financing is recognised in proportion with the related expenditure). Recognition of targeted financing uses gross method, on the basis of which the compensated expenses and received support shall be recognised separately in the income statement.

### **Tax accounts**

Irrecoverable taxes and fees paid at the time of the acquisition of fixed assets (e.g. value added tax, if the buyer is not liable to value added tax) are recognised as expenditure at the time of acquisition and they are excluded from the acquisition cost of the assets.

### **Operations conducted in foreign currency**

Operations conducted in foreign currency are recognised on the basis of the official exchange rate of the Bank of Estonia at date of the operation. Gains and losses from the foreign exchange operations are recognised on the income statement as the profit and loss for the period.

### **Net financing from the state budget**

Acquisition of fixed assets and expenses is recovered from the state budget and recognised as transfers received. The transfer of calculated revenue to the state budget is recognised as transfers made.

Mihkel Oviir  
Auditor General

Mihkel Oviir  
Auditor General

**Note 2**  
**Cash and its equivalents**

The Treasury makes transfers from the NAO budget and administers all the receipts belonging to the NAO.

In 2006, the NAO used only the accounts belonging to the group account.

**Note 3**  
**Transactions with public sector and associated bodies**  
(in kroons)

**I. Liabilities and claims**

	<u>Short-term liabilities</u>		<u>Short-term claims</u>	
	<u>31.12.2006</u>	<u>31.12.2005</u>	<u>31.12.2006</u>	<u>31.12.2005</u>
Tax and Customs Board	806	27 585	0	0
Other public sector entities	9 079	15 294	0	0
<b>Total state accounting entities</b>	<b>9 885</b>	<b>42 879</b>	<b>0</b>	<b>0</b>
<b>Total associated bodies</b>	<b>25 394</b>	<b>14 849</b>	<b>0</b>	<b>0</b>

Liabilities to the Tax and Customs Board are specified in Note 9.

Liabilities to enterprises are entered under the balance sheet item "Arrears to suppliers".

**II. Expenditure**

	<u>Personnel Management</u>		<u>Tax and fee</u>	<u>Total</u>
	<u>expenses</u>	<u>expenses</u>	<u>expenses</u>	<u>expenses</u>
<b>State accounting entities</b>	<b>27 083</b>	<b>586 757</b>	<b>1 746 141</b>	<b>2 359 981</b>
<b>Associated bodies</b>	<b>0</b>	<b>173 289</b>	<b>0</b>	<b>173 289</b>

VAT formed EEK 1,739,896 and land tax expenses EEK 6,245 from the tax expenses

**III. Revenue**

	<u>From</u>
	<u>targeted financing</u>
State Chancellery	333 158
<b>Total state accounting entities</b>	<b>333 158</b>

Revenue was formed by support from State Chancellery for the measure 1.4 project „Improving Administrative Capacity".

**Note 4**

**Other claims and advance payments**

(in kroons)

	31.12.2006	31.12.2005
Expenses of future periods paid in advance	212 106	129 922
Claims	1 069	0
Deductions from wages	6 324	1 300
<b>Total other claims and advance payments</b>	<b>219 499</b>	<b>131 222</b>

The majority of the expenses of future periods paid in advance are the advance payments for periodicals in 2007 – EEK 131,177 (as at 31.12.2005, the advance payments for periodicals formed EEK 113,437)

**Note 5**

**Tangible fixed assets**

(in kroons)

	Land	Buildings & civil engineering works	Machinery & equipment	Other fixed assets	Total
<b>Acquisition cost as at 31.12.2005</b>	<b>0</b>	<b>29 649 549</b>	<b>3 854 188</b>	<b>3 059 074</b>	<b>36 562 811</b>
Accumulated depreciation as at 31.12.2005	0	-8 031 868	-3 308 751	-2 785 549	-14 126 168
<b>Residual value as at 31.12.2005</b>	<b>0</b>	<b>21 617 681</b>	<b>545 437</b>	<b>273 525</b>	<b>22 436 643</b>
<b>Changes in 2006</b>					
Acquisition and improvement of assets	0	0	169 549	0	169 549
Reclassifications	1 040 800	-1 040 800	0	0	0
Write-off	0	0	-993 762	-157 126	-1 150 888
Depreciation	0	-867 132	-374 214	-115 615	-1 356 961
Depreciation of sold and written-off fixed assets	0	0	993 762	157 126	1 150 888
<b>Acquisition cost as at 31.12.2006</b>	<b>1 040 800</b>	<b>28 608 749</b>	<b>3 029 975</b>	<b>2 901 948</b>	<b>35 581 472</b>
Accumulated depreciation as at 31.12.2006	0	-8 899 000	-2 689 203	-2 744 038	-14 332 241
<b>Residual value as at 31.12.2006</b>	<b>1 040 800</b>	<b>19 709 749</b>	<b>340 772</b>	<b>157 910</b>	<b>21 249 231</b>

**Land**

Land at cost value of 1,040,800 kroons (allocated from the price of the registered immovable) was recognised in the accounting period as fixed assets.

**Machinery and equipment**

3 servers were bought in 2006.

During the year, depreciated IT equipment in the acquisition value of 813,762 kroons and an automobile OPEL ASTRA 1,6 in the acquisition value of 180,000 kroons were written off. Of that, assets in the value of 178,378 kroons were destroyed (7 PCs and 3 printers) and assets in the value of 798,754 kroons were transferred upon requests.

The assets were transferred to Heateo SA in the value of 618,754 kroons (15 PCs and 13 laptops) and

Tallinn Children's Home in the value of 180,000 (automobile Opel ASTRA).

**Other fixed assets**

Franking machine in the value of 21,719 kroons and office furniture in the value of 135,407 kroons were written off as unserviceable assets.

**Note 6****Intangible fixed assets**

(in kroons)

	Software	Total
<b>Acquisition cost as at 31.12.2005</b>	<b>296 281</b>	<b>296 281</b>
Accumulated depreciation as at 31.12.2005	-208 289	-208 289
<b>Residual value as at 31.12.2005</b>	<b>87 992</b>	<b>87 992</b>
<b>Changes in 2006</b>		
Acquisition	1 516 750	<b>1 516 750</b>
Depreciation	-85 654	<b>-85 654</b>
<b>Acquisition cost as at 31.12.2006</b>	<b>1 813 031</b>	<b>1 813 031</b>
Accumulated depreciation as at 31.12.2006	-293 943	-293 943
<b>Residual value as at 31.12.2006</b>	<b>1 519 088</b>	<b>1 519 088</b>

Audit administration software TeamMate was purchased in 2006, which enables to improve the audits' quality process. A firewall was also purchased.

**Note 7****Operational lease**

(in kroons)

	Payments			
	2005	2006	2007	2008-2009
Paid and estimated operational lease payments	96 725	172 777	156 082	170 090

In 2006, the NAO leased the following machines and equipment on the basis of operational ease contracts:  
 an automobile Volvo  
 2 automobiles Opel

A contract with the expiry date on 15.05.2008 has been concluded for the ease of an automobile Volvo..

A contract for the period of 24.04.2006-23.04.2009 was concluded for 2 automobiles Opel.

Upon termination of contract, the lessor does not impose fines on the NAO.

**Note 8****Arrears to suppliers and employees**

(in kroons)

	31.12.2006	31.12.2005
Arrears to suppliers	519 679	120 129
Arrears to employees	1 987 919	1 117 925

Most of arrears to suppliers are formed by arrears for fixed assets in the value of 425,573 kroons (incl. auditing software TeamMate in the value of 417,795 kroons).

Arrears to employees are recognised as holiday pay liability due as at 31.12.2006 in the value of 1,987,919 kroons.

Mihkel Oviir  
Auditor General

**Note 9**  
**Other claims and advance payments**  
(in kroons)

	<b>Tax arrears</b>	
	<b>31.12.2006</b>	<b>31.12.2005</b>
Social tax	474	16 434
Income tax added to the fringe benefits	332	11 151
Credit card	36 592	0
<b>Total</b>	<b>37 398</b>	<b>27 585</b>

**Note 10**  
**Management expenses**  
(in kroons)

	<b>2006</b>	<b>2005</b>
Information and communications technology expenses	2 197 727	997 119
Administration expenses	1 983 208	1 392 141
Administrative expenses on reg. immovables, buildings and roads	873 718	1 701 872
Expenses on training tools and training	1 178 069	485 306
Mission expenses	963 753	698 324
Research and development expenses	832 537	144 357
Expenses on the management of inventory	526 566	338 519
Vehicle maintenance expenses	417 737	256 118
Other expenses	196 482	25 358
<b>Total management expenses</b>	<b>10 169 797</b>	<b>6 039 114</b>

**Note 11**  
**Net financing from the state budget**  
(in kroons)

Cash transfers from the state budget	<b>49 046 050</b>
Received from the state budget for making transfers	49 405 928
Receipts transferred to the state budget	-359 878
Transfers from the income statement	49 993 446
<b>Revenue accrued to the state budget as at 31.12.2005</b>	<b>21 390 218</b>
Net transfer for transferring the difference in the cash and accrual accounting results to the state budget	947 396
<b>Revenue accrued to the state budget as at 31.12.2006</b>	<b>20 442 822</b>

**Note 12**  
**Grants awarded**  
(in kroons)

	<b>2006</b>	<b>2005</b>
EUROSAI	7 323	7 323
INTOSAI	5 319	4 682
<b>Total membership fees</b>	<b>12 642</b>	<b>12 005</b>

The NAO is the member of INTOSAI already since 1992 and the member of the regional association EUROSAI since 1993.

Mihkel Oviir  
Auditor General

**Note 13**  
**Labour costs**  
(in kroons)

Töötasukulud	2006				2005	
	Graduated & basic salary	Additional performance tasud	Holiday pay	Grants & benefits	Total remuneration costs	Total remuneration costs
Officials						
Auditor General	537 636	107 531	97 165	0	742 332	686 006
Higher officials	6 700 203	1 431 267	1 295 712	598 702	10 025 884	7 184 818
Senior officials	10 718 397	2 121 686	1 982 976	1 016 343	15 839 402	10 633 801
Junior officials	13 000	0	483	0	13 483	307 054
<b>Total officials</b>	<b>17 969 236</b>	<b>3 660 484</b>	<b>3 376 336</b>	<b>1 615 045</b>	<b>26 621 101</b>	<b>18 811 679</b>
Employees						
Workers and support staff	88 301	0	13 380	6 000	107 681	97 950
<b>Total employees</b>	<b>88 301</b>	<b>0</b>	<b>13 380</b>	<b>6 000</b>	<b>107 681</b>	<b>97 950</b>
<b>Temporary staff</b>	<b>336 704</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>336 704</b>	<b>127 200</b>
<b>Total remuneration costs</b>	<b>18 394 241</b>	<b>3 660 484</b>	<b>3 389 716</b>	<b>1 621 045</b>	<b>27 065 486</b>	<b>19 036 829</b>

Average number of employees	2006	2005
Officials		
Auditor General	1,00	1,00
Higher officials	26,03	22,87
Senior officials	66,13	49,94
Junior officials	0,00	3,13
<b>Total officials</b>	<b>93,16</b>	<b>76,94</b>
Employees		
Workers and support staff	1,00	1,00
<b>Total employees</b>	<b>1,00</b>	<b>1,00</b>

Fringe benefits	2006	2005
Write-off of study loans	186 170	170 840
Other fringe benefits	313 512	288 272
<b>Total fringe benefits</b>	<b>499 682</b>	<b>459 112</b>

Taxes and social security contributions	2006	2005
Social tax on wages	8 935 790	6 282 661
Unemployment insurance premiums	78 970	90 274
Income tax on fringe benefits	156 417	152 563
Social tax on fringe benefits	216 174	209 775
<b>Total taxes and social security contributions</b>	<b>9 387 351</b>	<b>6 735 273</b>

Remuneration to the management forms 3,427,100 kroons from the remuneration costs.

The management did not receive any additional fringe benefits.

The management includes the Auditor General, Directors of Audit and the Director of Corporate Services.

Mihkel Oviir  
Auditor General



## 4. Opinion on the NAO internal control system

As the Auditor General, I find that the NAO internal control system is efficient, i.e. the system is effectively operational, conforms to the rules of procedure, and ensures the agency's legitimate and economic performance and the protection of resources.

The NAO internal control system includes structure, management attitudes, applicable procedures and other measures providing reasonable assurance that:

- the Office's operations are legitimate;
- the Office's assets are protected from damage resulting from wasting, unintended use, fraud, incompetent management, etc;
- the Office conducts its business economically, efficiently and effectively, and ensures high quality of services;
- the management and financial information reflecting the Office's business is reliable, accurate and timely.

The NAO has established statutory and internal rules of procedure which are respected and monitored as to compliance. The separation of duties has been ensured in the performance of the Office's functions and in the documentation and authorisation of transactions, and supervision is exercised.

Mihkel Oviir  
Auditor General

## 5. Signatures to the annual report

The NAO annual report for the financial year that ended on 31.12.06 consists of the management report and annual accounts.

The management report and the annual accounts have been drafted by the executive management of the NAO. The Auditor General and the Director have examined the annual report.

Mihkel Oviir  
Auditor General

Tõnis Saar  
Director of National Audit Office

30.05.2007

## 6. Auditor's report