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Dear reader!

In 2005, the National Audit Office also worked to bring real benefit to the state by providing expert observations, opinions and proposals. 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.

Upon drawing up the 2005 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. And people. Good people. We have such people and they keep coming. I am also glad that staff turnover has decreased, compared to previous years. It is relevant because historical memory is very important in the profession of an auditor, just as it is in any other profession. An auditor without memory is like a “mankurt” – helpless and pointless.

Many people in our building carried out their first, second or third audit in 2005. 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. I hope that everyone who has acquired experience and knowledge over the years can offer their assistance to our young colleagues. It takes years to become an auditor and our duty is to help the people who have chosen this road.

In 2004, I decided to change the NAO's structure from that based on audit types to that based on ministries. 2005 was the first full year the new structure was applied. In order to provide expert advice to the auditees, the people providing the advice have to be familiar with the respective field – the new structure helps the auditors to delve into their area of activity. Only then can the NAO make expert proposals that can really be useful, so that we together can change our country for the better.

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 questions that are primary in the life of the state and that require hundreds of millions or even billions 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

1. Core activity of the National Audit Office

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 proposals to improve 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 proposals the NAO helps those whose job it 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.

Upon 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.

Upon 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 2005 the structure of the National Audit Office was as follows:

Audit Department I audits the area of government of the Ministry of Finance, Ministry of Foreign Affairs, State Chancellery and constitutional institutions. Chief Auditor is **Ines Metsalu**.

Audit Department II audits the area of government of the Ministry of Justice, Ministry of Defence and the Ministry of Internal Affairs as well as county governments. Tõnis Saar acted as Chief Auditor for part of the year. In autumn 2005, **Ülle Madise** became Chief Auditor.

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

The auditors of **Audit Department IV** are responsible for auditing the area of government of the Ministry of the Environment, Ministry of Economic Affairs and Communications and the Ministry of Agriculture. Chief Auditor is **Olav Lüüs**.

In 11.05.2005, the Parliament adopted the State Audit Office Act and Local Government Organization Act Amendment Act, which provided the NAO with the right to exercise economic control over local governments, irrespective of whether the matter concerns state assets or municipal property. In the case of municipal property, the regulator limited the scope of control with legality control to ensure compliance with the local government autonomy principle arising from § 154 of the constitution.

In the opinion of the Ministry of Justice the NAO's surveillance regarding local governments helps to strengthen control over legitimate and purposeful use of the funds of the public sector. Reinforcing surveillance also helps to decrease the risk of corruption and disclose potential corruption cases.

In 31.05.2005 President Arnold Rüütel signed a resolution in Kadriorg to proclaim the State Audit Office Act and Local Government Organization Act Amendment Act adopted by the Parliament in 11.05.2005. Upon proclaiming the Act the head of state noted that it is relevant to facilitate the strengthening of prudent and responsible way of thinking in local governments. "Even if the influence of the state's central administration on local governments increases, the local level continues to be focused on citizens. The activities of the local government have a direct influence on the quality of the people's physical and social environment as well as the level of social security," the President said.

The Act entered into force in 1.01.2006. In 2005 the NAO made preparations for the formation of a new department, Audit Department V, so as to be ready for new obligations assigned to us by the Parliament. The Auditor General appointed **Krista Aasa** as Chief Auditor of Audit Department V.

1.2. Audit Department I

The auditees of Audit Department I include the Ministry of Finance, Ministry of Foreign Affairs, State Chancellery and constitutional institutions.

Upon the foundation of the department in December, 2004 the department employed seven people, by the end of 2005 the number of employees had risen to eleven.

In 2005, Audit Department I dealt with 17 audits, 13 of which were completed and four of which will be completed in 2006. Also, along with Audit Department IV the department participated in an *ad hoc* audit (“Efforts of the state authorities of Estonia to avoid generation of surplus sugar stock by the time of acceding to the European Union”). Audit reports drawn up as a result of the audit have been discussed in the State Budget Audit Committee, and the audit report on the consolidated report of the state in Finance Committee.

Mostly, the audits were carried out regarding the activities of state authorities, with one audit performed regarding the activities of a company owned by the state (Riigi Kinnisvara AS) and one audit performed on the activities of a local government. The department organized financial audits, audited the organization of public procurement, the use of EU funds and the activities of the Ministry of Finance in the accreditation of Structural Funds and the implementing agencies and entities of the Cohesion Fund as well as the efficiency of the activities of Riigi Kinnisvara AS in the administration of office premises. The objective of Audit Department I was to audit the accuracy of the consolidated annual report of the state and the legality of transactions. The audit was carried out in cooperation with the other audit departments.

In cooperation with the Methodology, Planning and Reporting Service of the NAO the department’s auditors have engaged in supplementing the audit’s methodological materials, and we have participated in internal trainings as training providers.

Important audit results

The objective of the NAO is to ensure the correctness and accuracy of the financial accounts of the state as well as the compliance of the state’s economic transactions with the law, their documentation and disclosure as required.

Audit Department I audited the accounting and the legality of transactions in four constitutional institutions, two ministries, State Chancellery and two state authorities. When 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. On the basis of the audits performed in 2005 we can state that accounting was well organized in the audited authorities and that the implementation of the general rules of state accountancy has been carried out without any big problems.

“The audit report of the NAO on the 2004 consolidated annual report of the state”

The State Budget Act establishes the obligation of the NAO to evaluate the accuracy of the consolidated annual report of the state and the legality of transactions of the state. 2005 was the first year when, in the initiation of Audit Department I, an audit report was completed on the consolidated annual report of the state. Due to shortcomings in accounting and control system the NAO did not disclose its opinion on the accuracy of the 2004 consolidated annual report of the state and the legality of transactions of the state.

The audit report of the NAO should be an interesting reading material for those, who wish to know which ministries have managed their accounting well and which ministries have the most problems. In the audit report we made proposals to the Minister of Finance to improve the accounting and internal control systems, to bring the model audit into conformity with internationally accepted auditing principles, to amend the State Budget Act and develop the management reporting of the public sector. In the framework of the 2006 audit we intend to make sure that the Minister of Finance, who has supported the proposals of the NAO, has taken steps to bring them to life.

“Activity of Riigi Kinnisvara AS in managing office space leasing”

In 2005 we audited the activity of Riigi Kinnisvara AS in managing office space leasing. The main conclusions of the audit were recorded in the NAO’s annual overview on the use and preservation of state assets. The NAO identified that the aims set upon the foundation of Riigi Kinnisvara AS had not been met. There are no definite principles in place for determining the rental price of office spaces and thus the amount of rent charged from each state authority is agreed individually, not under generally understood criteria and it is not possible to budget the costs of office space renting on state level. Also, there are no reliable data on the second component of budgeting – the aggregate amount of office space at the disposal of state authorities.

Current surveys show that the size of office space per official varies greatly (5–38 m²) and that on the average, state authorities use over 30% more space per official than private businesses. Based on the shortcomings identified in the course of the audit, the Government of the Republic assigned the Minister of Finance the task of presenting to the Government the overview of the company’s current activity and future trends of development. Said problems remain unsolved and the NAO continues the process of auditing matters related to government real estate in 2006 as well.

In 2006, relevant issues from the viewpoint of Audit Department I are the use of the European Union funds and auditing of tax revenue, and we wish to continue making proposals regarding the improvement of the quality of the state’s financial reporting.

Ines Metsalu
Chief Auditor
Audit Department I

1.3. Audit Department II

Audit Department II audits the area of government of the Ministry of Justice, Ministry of Defence and the Ministry of Internal Affairs as well as county governments. In 2005, Audit Department II carried out 19 audits; three of them shall be completed in 2006.

Important audit results

Financial audits have contributed to the continual development of the accounting of the public sector, and as a result the financial reporting of the public sector has improved significantly. In the course of auditing activities more attention is paid to the financial management and internal control system and proposals have been made to solve identified problems.

Organization of accounting, economic activities and the legality of transactions

In addition to auditing the organization of accounting and the legality of transactions of the areas of government of the Ministry of Justice, Ministry of Defence and the Ministry of Internal Affairs, the NAO performed a separate audit in 2005 on the organization of accounting of Saare County Government and institutions under its authority, the organization of accounting and economic activities of Estonian Border Guard Aviation Group, organization of accounting and economic activities of Single Signal Battalion, organization of accounting and economic activities of Naval Headquarters, organization of accounting and economic activities of Tartu Prison and the organization of accounting and economic activities of Central Criminal Police.

By now, the **Estonian Border Guard Aviation Group** has corrected the accounting of state assets and calculations of cost price for charter flights; **Tartu Prison** has reduced its cash flow to the minimum; **Saare County Government** has improved the accounting of fixed assets and revenue accrued from economic activities; **Single Signal Battalion** supplemented its accounting policies and procedures in order to meet the proposals of the NAO, the commanding officer appointed a person who is responsible for the conclusion of agreements, etc. Said changes help to ensure the preservation of state assets and the accrual of all revenue from economic activities into the state budget.

The audit of the economic activities of **E-Arsenal Ltd** drew attention to the fact that the company does not make profit, which is why the continuation of its activities causes loss to the state. After the NAO's audit (Audit report from 21.03.2005) the Ministry of Defence started to make changes in the company as of April, 2005 in order to restructure E-Arsenal Ltd. By the summer of 2005, both the supervisory board and the management board of E-Arsenal Ltd had been replaced with new ones. In May, 2005 the Minister of Defence responded to the inquiry of the State Budget Committee of the Parliament on the future fate of E-Arsenal Ltd that as the company is one of the most important symbols of the Estonian defence industry, it is not possible to support the plan of the company's former board to transfer the company. The Ministry of Defence finds that the activity of E-Arsenal Ltd should be radically restructured.

Upon auditing the **Naval Headquarters** the NAO identified shortcomings in the internal control system, insufficiently documented construction costs and errors in calculation of remuneration. Development of procedures and rules for checking the fuel consumption of ships is in process.

As a separate topic the NAO analyzed the activities of **the Ministry of Justice, Ministry of Defence and the Ministry of Internal Affairs** in the management of state-owned buildings. By now the ministries have a plan of action for the disposal of unneeded buildings or of buildings that cause loss to the state, and this plan is being carried out. The attention of the Ministry of the Environment, Ministry of Internal Affairs and the State Budget Audit Committee of the Parliament was drawn to the need to eliminate the sources of oil pollution residue in Kopli peninsula.

To fulfil Estonia's international obligation the NAO audited the 2004 annual accounts of the **Baltic Defence College**, demanding the timely and full documentation of transactions.

“Prevention of fires in residential buildings”

As a result of the audit the system of surveillance and prevention measures was reviewed one more time in order to achieve better results in the prevention of fires with existing resources.

“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 approximately 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 the Public Prosecutor's Office shall arrange for an inventory of examination rulings, unnecessary expert analyses have been or are being 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 Ministry of Internal Affairs and the Ministry of Justice are preparing for the merger of forensic institutions.

“Response of the Auditor General to the inquiry of Peeter Kreitzberg, member of the Parliament, on leasing premises to the Police in Tallinn and Tartu”

Audit Department II prepared a response to the inquiry of Peeter Kreitzberg on leasing premises to the Police in Tallinn and Tartu. In his response to the inquiry the Auditor General stressed that the decision to lease premises to state authorities has to be based on analysis and afterwards it should be possible to assess the entire decision making process. Only then can decision-making officials avoid the suspicions of corruption and suspicions of making decisions that could harm the state.

Ülle Madise
Chief Auditor

Audit Department II

1.4. Audit Department III

Audit Department III audits the area of government of the Ministry of Education and Research, Ministry of Culture and the Ministry of Social Affairs. The expenses 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. Large part of the auditees are legal persons governed by public law and foundations founded by the state.

As of the end of 2005, the department employed 18 officials – 14 auditors, three audit managers and chief auditor.

In 2005, the department carried out 36 audits, 25 of them were completed. We forwarded all audit reports to the State Budget Audit Committee of the Parliament. In several cases we informed the standing committees of the Parliament of the results of the completed audit, and those committees organized discussions of audit results, if necessary.

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 2004 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 specific state authority or 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. allocations for boarding school facilities or for the payment of education allowance).

Mostly the auditees included state authorities but our audits also covered the activities of several foundations founded by the state (Eesti Draamateater Foundation, Northern Estonian Regional Hospital Foundation, Rural Development Foundation, Foundation Innove) and legal persons governed by public law (Estonian Academy of Arts, Estonian Health Insurance Fund).

Important audit results

“Quality assurance in vocational education”

The audit of the assessment of the quality of vocational education focused on the satisfaction and inclusion of entrepreneurs and dealt with the activity of the Ministry of Education and Research as well as with the measures implemented to improve the quality of education in twelve vocational schools. The main conclusion of the audit was that the quality of vocational education is very uneven and depends greatly on the region, school and taught speciality. The Ministry as a coordinating body has a lot to accomplish in order to harmonize the quality of vocational education: develop an accreditation system, improve the collection of data on people who have interrupted their studies, unemployed people and on the satisfaction of entrepreneurs, develop the national curricula, specify the role and responsibility of school boards of vocational educational institutions.

“Estonian Vocational Education Development Plan for 2005–2008” was adopted after the completion of the audit, and improving the quality of vocational education has been named as one of its main objectives; this would bring along the increase in the popularity of vocational education, increase in the number of students and the graduates’ successful placement to work. At the end of 2005 the Vocational Educational Institutions Act was amended, among other things amendments covered the specification of the definition of practice and regulation of school boards of vocational educational institutions as well as the establishment of the requirement of cooperation with social partners while drawing up the national curricula.

“Economic activities of the Estonian Academy of Arts in 2004”

The audit of the economic activities of the Estonian Academy of Arts in 2004 covered all its structural units, as well as the foundation and company founded by the Academy.

Universities who act as legal persons governed by public law are the owners of their assets, but the management of assets has to be carried out in compliance with the requirements provided by legislation and prudently. The Academy had entered into contracts for management of the Academy's buildings with the foundation founded by the Academy. However, in several cases the foundation had failed to fulfil the duties assigned to it. The Academy had not analysed the profitability of the management of the buildings by the foundation in comparison with the management of its buildings itself while ordering maintenance services from various service providers where necessary. The Academy had not organized public auctions to find tenants and fixed assets were sold without organizing an auction, thus violating the law. Upon purchasing goods and services the Academy did not organise a public procurement.

The current rector of the Academy and the Board were serious about the identified shortcomings. Thus, the Board decided to initiate the liquidation proceeding of the foundation and terminate the contracts causing loss for the Academy, establish rules of procedure for public procurement, etc.

“Accounting, preservation and use of museum assets”

In the course of auditing the accounting, preservation and use of museum assets the NAO evaluated how well the museum collections as state assets are preserved and how is access ensured for the public. It was revealed that there was no exact overview of all museum collections. In some museums, the last thorough inventories had taken place 20 to 30 years ago. All museums have not been able to take an extensive scientific inventory (scientific description of things of cultural value), and thus the state lacks a thorough overview of the cultural goods in museum collections.

Only one third of the examined collection storage facilities possessed good or satisfactory preservation conditions of museum assets. The biggest problem of the Estonian museums was the lack of space.

Sound preconditions for the use of museum assets had been not created: there was no functioning information system, museums could not provide suitable conditions for examining the museum items, only 1.3 per cent of museum items can be displayed.

The NAO made proposals to the Minister of Culture to develop a long-term collection policy and investment plan, ensure the taking of inventories in the museums in accordance with the established procedure. Additionally, develop a common information system of museum items to provide access to the museum items for researchers, hobbyists and the general public.

By now the general rules of state accountancy have been amended in a way that due to their large amount, inventory of museum items as fixed assets can exceptionally be taken once every five year instead of once a year. The Ministry of Culture has developed main trends of the development of museums for the period of 2006–2016.

“Economic activities of the Eesti Draamateater Foundation”

The audit of the economic activities of the Eesti Draamateater Foundation covered the liquidation proceedings of Eesti Draamateater as a public institution and establishing a foundation instead, financial management of a theatre operating as a foundation as well as the functioning of an internal control system and the legality of transactions.

The audit revealed that the Ministry of Culture had failed to ensure the required liquidation of the theatre as a public institution – no inventory was taken or the closing balance sheet of liquidation approved, the liquidation committee had not approved the majority of asset transactions in this period, etc. In his response, the Minister stated that the listed shortcomings were due to the officials' lack of experience and that the liquidation proceedings of state authorities shall be efficiently monitored in the future.

The Council took specific measures in order to eliminate the shortcomings identified in the financial management and internal control of the foundation.

As several of the problems identified in the course of the audit are also relevant from the point of view of other theatres, the newspaper "Postimees" organized a public discussion on the basis of the results of the audit, with the participation of the representatives of the Parliament, Ministry of Culture, Ministry of Finance, the NAO and theatrical circles. One of the conclusions was that managers of theatres need more training in financial management.

"Need for employees and state-commissioned education in the health field"

The objective of the audit was to evaluate whether the state can guarantee the sufficient supply of health care professionals for the current health system so that quality health care would be provided within a reasonable amount of time.

The audit revealed that the actual labour force in the health care sector is substantially smaller than the registered amount of health care professionals; the estimated need for health care professionals in the development plans does not accord with the actual situation nor with the needs of existing hospitals; it is impossible to maintain the existing number of doctors and to increase the number of nurses sufficiently through state-commissioned education.

To improve the situation, the NAO made proposals to the Minister of Social Affairs to reorganize the register and process of registration of health care professionals; ensure the conformity of the development plans of different levels; analyze the current hospital network; ensure the graduates of main courses of the medical faculty a better possibility to pursue studies in residency and review study programme for nurse assistant.

Of the important events that took place after the end of the audit, attention could be drawn to the following: in 03.02.2006, the Ministry of Social Affairs, the Faculty of Medicine of the University of Tartu and the Estonian Medical Association signed a consensus document for the state-commissioned education in the Faculty of Medicine for the period of 2006–2010, which should ensure the provision health services on current level.

"Organization of health care of preschool children"

As a result of the audit the NAO found that as nearly half of the examined first-formers have some kind of a health problem, the prevention of illnesses among preschool children and health promotion should be organized in a more efficient way. The examination of children's health is the responsibility of family physicians but the audit showed that family physicians have not periodically examined all children.

The audit revealed that 40% of childcare institutions do not employ a health care professional, as it is not compulsory. Tasks have been appointed to health care professionals pursuant to the law but it is not regulated if and who should carry out the tasks in their absence. As the number of health care professionals shall decrease even more in the future, it is necessary to review the duties and responsibility of health care professionals in child care institutions.

In his response, the Minister of Social Affairs stated that the Ministry will deal with the problems of preschool child care institutions and the health promotion, health protection and health care administration of all preschool child care institutions shall have to be reviewed.

"Overview of the use of the gambling tax"

Based on the wish of the State Budget Audit Committee of the Parliament, the Department prepared a special report on the use of the gambling tax, which is a summary of the four audits carried out by the NAO on the same topic (in 2002–2005).

As a result of the audits we found that the system that provides the basis for the current allocation of support out of the gambling tax is fragmented, too complicated and partially non-transparent. The NAO thought it necessary to consider the possibilities for the simplification of the system and to that end, prepared its proposals. The special report was discussed at the sitting of the State Budget Audit Committee of the Parliament.

Jüri Kõrge
Chief Auditor

Audit Department III

1.5. Audit Department IV

Audit Department IV evaluates the Ministry of the Environment, Ministry of Economic Affairs and Communications and the Ministry of Agriculture 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; also companies where the ministers at the head of said ministries have a right 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.

The department was founded in December, 2004 with ten employees. Seven new employees were employed in the next year and three people left, i.e. at the end of the year, the department employed 14 people.

The department had three positions for audit managers. One of them was filled in the middle of 2005, a senior auditor performed the duties of one audit manager for the entire year, and one position remained vacant for the entire year. As of 2006, all three positions have been filled with people who worked in the department in 2005, i.e. the management structure planned for 2005 has already been implemented.

The first working year of the department was the year of getting an overview of the auditee authorities and areas as well as the year of shaping the working collective, for several employees this was also the year for their first experience in auditing. Lack of experience required for auditing and the lack of officials with necessary experience to manage the audits was the main problems of the department in 2005.

Within the year, 17 audits were started and 13 audits were completed with an audit report, including six of those that had been started in 2004. Five of the completed audits were financial audits. In the case of two audits it was decided after the termination of pre-studies that auditing procedures were 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. The department also prepared three memoranda of the Auditor General for the committees of the Parliament in connection with draft Acts processed in the Parliament.

Important audit results

The general public paid the most attention to the following audits.

“Efforts of the state authorities of Estonia to avoid generation of surplus sugar stock by the time of acceding to the European Union”

Prior to the accession to the European Union of the new Member States, the European Commission had established that the acceding states have to make payments into the Union's budget from the stock of agricultural and food products created for speculative purposes. After the accession, the stock of 22 products were regarded as surplus in Estonia and based on those amounts it was calculated that Estonia should make payments to the Union's budget for more than a billion kroons, 715 million of that due to excess sugar stock.

The NAO inspected whether it would have been possible for the Government to prevent the generation of surplus stock. As a result of the audit, the NAO reached a conclusion that if the Government would have taken measures at an appropriate time, it is likely that it would have been possible to prevent the generation of very large stocks.

After examining the audit report, the special committee of the Parliament concurred with the conclusions of the NAO and noted that state authorities could not sufficiently acknowledge the problem of surplus stock of food products and establish responsibility. As a reason for the situation formed by the moment of accession, the committee also mentioned the political differences of the Government and the inability of the then Prime Minister to make the Government work as a team.

“Exploitation of peat resources”

Having audited the state’s activity in planning use of peat resources and managing their extraction, the NAO stated that the use of peat reserves had not been organised in a sustainable way (the Government had permitted to extract peat and the rate of extraction greatly exceeded the rate of the natural creation of peat), insufficient attention had been paid on the environmental impact assessment when granting peat extraction permits, degraded peatlands had not been rehabilitated and the fee asked for the extraction permit was too small.

At first the Ministry of the Environment did not concur with many of the observations of the NAO, but initiated draft legislations to implement the proposals provided in the audit report. With the Environmental Fees Act, the fee for the right to extract peat was tripled. As of 2006, the Government established new (smaller than before) sizes for the critical and usable resources of peat and reduced the annual usage rates, thus basically putting a stop to the issuing of extraction permits.

“Use of land and buildings under the management of the Ministry of Agriculture not needed by state authorities”

The NAO stated that the activity of the Ministry of Agriculture in organizing the management of the state’s buildings and land has been neither purposeful nor systematical. It remained unclear which part of the state assets given to the use of other people will be needed in the future, and for what purposes. Data about the managed property were inaccurate. The use of assets had been granted at unfavourable terms to the state and the Ministry was not even aware of some agreements on the use of state assets.

Upon planning the 2006 budget, the Ministry made provisions for the transfer of most of the assets unnecessary to it.

“Management of the state’s IT sector and effectiveness of development plans”

With this audit, which was mainly carried out by the included expert, the NAO stated that the insufficient coordination of the IT sector impedes the development of information society. Upon developing the field of information technology in the public sector, the main problem does not concern the lack of funding, but rather the purposeful use of those funds. The Government of the Republic Act does not establish any ministry’s responsibility for the wholesome development of this field. It remains uncertain whether the funds allocated to the IT sector are used in the best way possible.

The NAO made a proposal to the Minister of Finance to regard the development of information society in the state budget strategy as a cross-ministry area of activity until at least 2010; In the state budget strategy financing plan, provide for at least 1% of the state budget a year to the financing of IT-sector; in the state budget strategy provide that innovative activity in developing information society is carried out through the framework of the specific research programme financed through the budget of the Ministry of Economic Affairs and Communications in the.

The media recorded the viewpoints of the NAO and the general public concurred with them but no specific decisions were made in 2005.

The media also recorded the audit report that dealt with the use of the amount of 910,000 kroons given to Keila Commune by the Estonian Privatisation Agency regarding the municipalisation of state assets

in 2000. The NAO's point of view was that in order to receive the said amount of money, the commune had submitted incorrect information to the Privatisation Agency and had not used the received funds purposefully. The commune did not concur with the conclusion of the NAO and submitted an application to the Court to make the NAO change its opinions (since the re-establishment of the NAO, this was the first time when its opinions had been contested in court). The court accepted the complaint but did not adopt a decision on this matter in 2005. The commune also contested the precept of the Ministry of Finance to repay the sum in question to the state, but no decision was adopted concerning this matter in 2005.

There are two other audits that the department would like to point out as relevant audits (the general public did not pay that much attention to these).

“Organization of formation and preservation of the State Grain Reserve”

The NAO stated that the procedure established by the Minister of Agriculture for forming, managing and replenishing of the security stock regulated most of the operations related to the security stock of grain. However, it was not entirely certain if the entire stock was still in place, that mostly because the grain was included in the stock without weighing.

The NAO noted that the organization of the security stock of grain failed to comply with several provisions. For example, the Government had not approved the assortment of the security stock of food grains and or minimum and maximum amounts, although respective requirement had been a part of National Stockpiles Act for almost seven years. Concerning the stowing the stock, reducing security risks has not been taken into consideration.

Again, the NAO made a proposal to the Minister of Agriculture to provide the size of the security stock of food grains and nomenclature. If the Ministry is of the opinion that the state should not have this stock or that the stock should be smaller than established with the Regulation of the Government of 1996, submit a new proposal to repeal this act. The Minister of Agriculture stated that he does not find it necessary for the state to own a security stock of food grains and that as of 2005 the stock is not renewed, but he did not make a proposal to the Government to liquidate the stock in 2005.

“Disclosure of surveys”

In the years 2001-2004, the state authorities ordered over 1,000 surveys for a total of 200 million kroons. In its audit the NAO found that about four fifths of those surveys were never publicized on a web site, as required by Public Information Act. The main reason for this is that it is obscure what the legislature means by the studies and analyses subject to disclosure and what kind of information about the studies should be made public and when. The Minister of Internal Affairs stated that the audit outcome did not reflect the deficiencies in the law, but the failure to comply with the provisions of the law. There were no significant changes regarding the disclosure of surveys in 2005.

Olav Lüüs
Chief Auditor

Audit Department IV

1.6. The NAO's audit reports in 2005

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

- Activity of the Ministry of Education and Research in the management of state-owned buildings
- Relocation of the Haapsalu Vocational Education Centre from Taebala to Uuemõisa
- Accounting and legality of the transactions in the area of government of the Ministry of Education and Research in 2004
- Economic activities of the Estonian Academy of Arts in 2004
- Economic activities of Estonian Maritime Academy 2004
- Organization of payment of study allowance
- Camps organised for youth and financing backing of them (follow-up audit)
- The economic activities of the foundations SEKR and Innove
- Utilisation of resources allocated to the project on student boarding houses
- Quality assurance in vocational education

Ministry of Justice

- Accounting and legality of the transactions in the area of government of the Ministry of Justice in 2004
- Organisation of accounting and economic activities of the Tartu Prison in 2004
- Waiting lists for forensic examination

Ministry of Defence

- Activity of the Ministry of Defence in the management of state-owned buildings
- Accounting and legality of the transactions in the area of government of the Ministry of Defence in 2004
- The opinion of the SAO on the 2004 annual accounts of the Baltic Defence College
- The economic activities of E-Arsenal Ltd in 2003–2004
- Organization of accounting and economic activities of Single Signal Battalion in 2004
- Organization of accounting and economic activities of Naval Headquarters in 2004

Ministry of the Environment

- Accounting and legality of the transactions in the area of government of the Ministry of the Environment in 2004
- Exploitation of peat resources

Ministry of Culture

- Accounting and legality of the transactions in the area of government of the Ministry of Culture in 2004
- Economic activities of the National Heritage Board in 2004
- Accounting, preservation and use of museum assets
- Economic activities of the Eesti Draamateater Foundation

Ministry of Economic Affairs and Communications

- Accounting and legality of the transactions in the area of government of the Ministry of Economic Affairs and Communications in 2004
- Organization of accounting and legality of the transactions in 2004
- Disclosure of surveys
- Use of the money given by the Estonian Privatisation Agency to Keila Commune in connection with the municipalisation of state assets
- Follow-up review on the audit of the 2002 annual report and the report on the state budget implementation by the Estonian Motor Vehicle Registration Centre

Ministry of Agriculture

- Use of land and buildings under the management of the Ministry of Agriculture not needed by state authorities
- Accounting and legality of the transactions in the area of government of the Ministry of Agriculture in 2004
- Organization of formation and preservation of the State Grain Reserve
- Efforts of the state authorities of Estonia to avoid generation of surplus sugar stock by the time of acceding to the European Union
- Economic activities of the Agricultural Research Centre in 2004
- Land improvement grants
- Economic activities of the Rural Development Foundation

Ministry of Finance

- Activity of Riigi Kinnisvara AS in managing office space leasing
- The audit report of the NAO on the 2004 consolidated annual report of the state
- Accounting and legality of the transactions of the Tax and Customs Board in 2004
- Accounting and legality of the transactions in the area of government of the Ministry of Finance in 2004
- Management of the state's IT sector and effectiveness of development plans
- Issue of licences for the provision of gambling activities and control over the operations of gambling providers
- Procurement of maintenance services

Ministry of Internal Affairs

- Accounting and legality of the transactions in the area of government of the Ministry of Internal Affairs in 2004
- Organization of accounting and economic activities of Central Criminal Police 2004
- Allocation and use of funds received from gambling tax for investments under regional programmes
- Organization of accounting and economic activities of Estonian Border Guard Aviation Group in 2004
- Waiting lists for forensic examination
- Organization of accounting of Saare County Government and institutions under its authority in 2004

Ministry of Social Affairs

- Accounting and legality of the transactions in the area of government of the Ministry of Social Affairs in 2004
- Organization of payment of the parental benefit
- Organisation of procurement in the Northern Estonian Regional Hospital Foundation
- Organization of health care of preschool children
- Need for employees and state-commissioned education in the health field
- Management of contracts for specialised medical services in the Estonian Health Insurance Fund
- The Activities of the Health Protection Inspectorate in Approval of Enterprises and in Supervision of Adherence to the Food Act

Ministry of Foreign Affairs

- Accounting and legality of the transactions of the Ministry of Foreign Affairs in 2004

Miscellaneous

- Economic activities of State Gazette Publisher in 2004
- Accounting and legality of the transactions of in the area of administration of the State Chancellery in 2004
- State Audit Office's opinion on the legality of the annual report and transactions of the Office of the President in the financial year 2004
- State Audit Office's opinion on the legality of the annual report and transactions of the Supreme Court in the financial year 2004
- State Audit Office's opinion on the legality of the annual report and transactions of the Chancellery of the Parliament in the financial year 2004
- State Audit Office's opinion on the legality of the annual report and transactions of the Chancellor of Justice in the financial year 2004
- Response of the Auditor General to the inquiry of 29.09.2005 of Peeter Kreitzberg, Member of Parliament on leasing premises to the Police in Tallinn and Tartu
- Response of the Auditor General to the inquiry based on the audit report “Efforts of the state authorities of Estonia to avoid generation of surplus sugar stock by the time of acceding to the European Union“
- Response of the Auditor General to written questions regarding the rental contracts of North Police Prefecture concluded in 2003 and South Police Prefecture concluded in 2004
- Overview of the use and preservation of state assets in 2004

1.7. Personnel

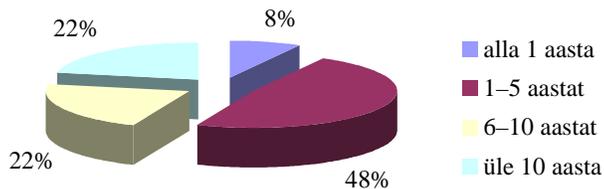
At the end of 2005, the NAO employed 87 persons. Despite of some staff turnover (11 %), there are 14 employees more compared to the beginning of the year, plus at the end of 2005 there were already agreements for employing further 13 persons in the new Local Government Audit Department to be established.

After the structural reform, 2005 was the year of reorientation and balancing. A lot of effort was put into developing the organisatio's overall strategy as well as the methodology of the core process. The external assessment by SIGMA experts was carried out in NAO which gave important information on progress and development needs.

The highlights of human resources work during the year include further development of the human resources policy and the salary system, increase of training volumes, catch-all evaluation of executives and the introduction of the management training program based thereon. Teleworking was implemented and a partner for providing the employees with comprehensive occupational health services was found.

A bit more than 10 % of the NAO staff have worked here for more than ten years, and the share of those who have just assumed office (12 %) and those who have worked 1-5 years (53 %) is quite big.

Figure 4. Length of service of NAO employees as of 31.12.2005



less than 1 year

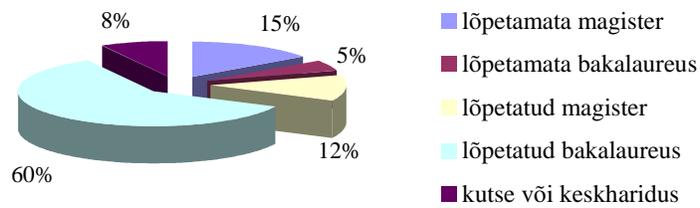
1 to 5 years

6 to 10 years

over 10 years

The vast majority of NAO employees have higher education – 87 %, whereof 15 % have an academic degree. Only 10 % 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 15 % of the staff will soon complete such studies.

Figure 5. Level of education of NAO employees as of 31.12.2005



unfinished Master's studies

unfinished Bachelor's studies

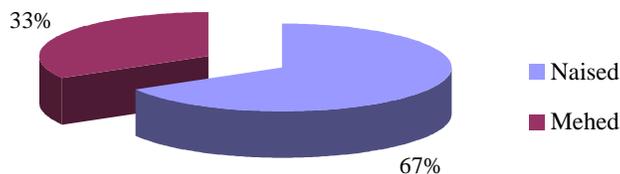
completed Master's studies

completed Bachelor's studies

vocational or secondary education

A continuing tendency is the prevalence of women in the NAO - at the end of the year the ratio between women and men was 2:1.

Figure 6. Distribution by gender of NAO employees as of 31.12.2005



Women

Men

The average age of staff is 37 years and the age group of 25 to 34 is the largest (53 %), followed by the age group of 35 to 44 (15 %).

Kairi Kübarsepp
Head of Personnel Service

1.8. International relations

2005 was the first full year of Estonia's membership in the EU and it was somewhat special for the NAO too. In spring, SIGMA started its peer review on the request of the Auditor General to provide an expert assessment on the NAO which involved the best experts on public sector audit from counterparties in the United Kingdom, Sweden, the Netherlands and Germany as well as experts from the NAO and the Estonian public institutions. A summary of the implementation of recommendations of the previous peer review in 1999 was prepared and the NAO's current activities were examined.

The autumn report noted that the NAO has strongly advanced and achieved considerable quality, but it also pointed out areas which could be further developed so as to achieve the full implementation of international standards and ensure compliance with the best audit practices. The NAO can still make the Estonian accountability system more effective. We consider the external opinion of top experts very useful and find that their recommendations and advice are to be taken into account and implemented.

On the initiative of the NAO and as a result of the peer review the SAIs and parliamentary audit committees of the United Kingdom, Ireland and Scotland were visited, Helir-Valdor Seeder, Chairman of the Parliamentary Committee for State Budget Audit being also a member of the delegation. The experience is used to devise proposals to develop the relations between the Parliament and the NAO.

As the year of EUROSAI Congress, the year 2005 was the time for summing up the three years' results of the organisation and setting targets for the new period. The discussion topics of the 6th Congress in Bonn were the meaning of public sector revenue for financial management and the Parliament's work, and the role of SAIs in the budgetary cycle and the auditing of budget revenue. The relevance of these issues has grown in connection with acceding to the EU and the practices of other countries provide a good basis for the NAO to draw up plans for meeting these challenges. As usual, the NAO participated in the meetings and workshops of INTOSAI and EUROSAI. Highlights include the presentation of the audit on the use of peat resources at the meeting of the Environmental Audit Working Groups of INTOSAI and EUROSAI, where it attracted a lot of attention from the colleagues; and participation in the work of the IT Working Group of EUROSAI with one of the outcomes being a self-assessment in the NAO in the field of IT.

In the framework of co-operation between the EU SAIs, the NAO participated in the meetings of working groups and liaison officers where important resolutions were prepared for the Stockholm meeting of the Contact Committee of the Heads of SAIs of Member States and the European Court of Audit. The resolutions concerned the strengthening of the role of SAIs in promoting accountability with regard to the use of EU funds. Measures were envisaged for making co-operation between themselves more effective and improving the awareness of other EU institutions and the public of its results.

In 2005, the Supreme Chamber of Control of Poland held in Gdansk the annual meeting of the SAIs of Baltic and Nordic countries and Poland. The leading issue was performance audit, but planning and follow-up audits were also covered, incl. by a presentation from the NAO representatives.

The NAO was visited by Hubert Weber, the President of the European Court of Audit (ECA) and Kersti Kaljulaid, a member of ECA. The latter introduced ECA's activities and presented the annual report for 2004. The NAO representatives were involved as observers in ECA's audit missions related to the milk quotas of new Member States and the provision of mutual assistance in customs matters. SIGMA expert, Andrew Anderson from the Scottish SAI visited and advised the NAO financial auditors. Delegations of the House of Deputies of Berlin and the officials of the Georgian Parliament came to examine the NAO's work.

In addition to workshops on public procurement, auditing, performance audits, etc, the NAO officers attended training periods on auditing public sector businesses and IT, and the international performance audit training in India.

The NAO contributed to holding in Riga the regional workshop on performance audit – the final event of the INTOSAI Development Initiative's (IDI) long-term training program designed for the Commonwealth of Independent States (CIS) and the Balkan countries.

Together with the representatives of the SAIs of Bulgaria, Poland, Hungary, Latvia and Lithuania and the IDI, the Auditor General attended as a visitor the annual meeting of the financial audit institutions of the CIS countries held in Moldova. It gave rise to the idea that a delegation of the Moldovan Court of Audit would visit the NAO in 2006 to discuss possibilities for co-operation and assistance from us.

International co-operation enriches all parties and facilitates the strategy adopted at INTOSAI's Congress in 2004 in Budapest.

Rein Söörd
Head of International Relations Service

2. Annual Accounts of the National Audit Office

Management's declaration

The Management declares its responsibility for drawing up the annual accounts of 2005 on pages 27 to 38 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

31.05.2006

Balance sheet

(in kroons)

	Note	31.12.2005	31.12.2004
Assets			
Current assets			
Other claims and advance payments	4	131 222	109 108
Total of current assets		131 222	109 108
Fixed assets			
Tangible fixed assets	5	22 436 642	23 401 574
Intangible fixed assets	6	87 992	110 641
Total of fixed assets		22 524 634	23 512 215
Total of assets		22 655 856	23 621 323
Liabilities			
Short-term liabilities			
Arrears to suppliers	8	120 129	146 555
Arrears to employees	8	1 117 924	721 886
Tax arrears and advance payments of taxes	3, 9	27 585	195 817
Total of short-term liabilities		1 265 638	1 064 258
Revenue accrued to the state budget	11	21 390 218	22 557 065
Total of liabilities		22 655 856	23 621 323

Mihkel Oviir
Auditor General

Income statement

(in kroons)

	Note	01.01.2005 -31.12.2005	01.01.2004- 31.12.2004
Operational revenue			
Other revenue		12 250	50 048
Total of operational revenue		12 250	50 048
Operational expenditure			
Labour costs			
Remuneration costs	14	-19 036 829	-17 592 272
Fringe benefits	14	-459 112	-650 683
Taxes and social security contributions	14	-6 735 273	-6 429 803
Total of labour costs		-26 231 214	-24 672 758
Management expenses	10	-6 039 114	-5 541 844
Tax, fee and fine expenses	3	-1 073 006	-1 331 442
Depreciation of fixed assets	5, 6	-2 074 994	-2 200 340
Grants awarded	12	-12 005	-12 309
Other operational expenditure		-1 084	0
Total of operational expenditure		-35 431 417	-33 758 693
Operating result	11	-35 419 167	-33 708 645
Financial revenue and expenditure			
Interest expenditure		0	-3 042
Total of financial revenue and expenditure		0	-3 042
Result of the period before the settlements with the state budget		-35 419 167	-33 711 687
Net financing from the state budget		35 419 167	33 711 687

Mihkel Oviir
Auditor General

Report on the execution of the budget

(in kroons)

Classification	2005		2004	
	Budget	Execution	Budget	Execution
Total of the revenue budget	0	12 250	0	50 048
35 Grants received	0	12 250	0	0
3500 Targeted financing for operational expenditure	0	12 250	0	0
38 Other revenue	0	0	0	50 048
3888 Insurance indemnity	0	0	0	50 048
Total of expenditure budget	35 515 971	33 953 348	34 007 672	33 998 742
4 Appropriations	13 000	12 110	14 000	12 309
4500 Membership fees	13 000	12 110	14 000	12 309
50 Personnel expenditure	25 681 800	25 681 800	23 833 600	23 833 600
500 Remuneration	18 800 400	18 722 829	17 477 000	17 652 079
505 Fringe benefits	328 600	280 818	254 000	222 738
506 Taxes and social security contributions from the personnel expenditure	6 552 800	6 678 153	6 102 600	5 958 783
55 Management expenses	7 154 171	7 154 170	6 200 000	6 199 964
5500 Administration expenses	1 700 160	1 630 142	1 576 413	1 583 547
5502 Costs of commissioned research and development	172 521	171 701	86 783	86 783
5503 Mission expenses	731 000	722 069	903 000	923 057
5504 Training expenses	560 000	602 091	526 000	539 414
5511 Management costs of reg. immovables, buildings & rooms	1 967 300	1 987 912	1 765 900	1 722 339
5513 Vehicle maintenance expenses	285 390	283 684	332 300	333 509
5514 Information and communications technology expenses	1 099 820	1 101 885	492 000	489 104
5515 Inventory costs	621 980	640 819	510 604	516 726
5522 Medical expenses	16 000	13 867	7 000	5 485
60 Taxes, fees, fines	7 000	6 245	0	0
6010 Land tax	7 000	6 245	0	0
65 Interest expenditure	0	0	4 000	3 590
6502 Interest expenditure on financial lease	0	0	4 000	3 590
Financing transactions	0	0	96 000	95 333
2082 Financial lease payments	0	0	96 000	95 333
15 Acquisition and renovation of tangible and intangible assets	2 660 000	1 099 023	3 860 072	3 853 946
1551 Renovation of civil engineering works	2 360 000	1 050 000	3 181 289	3 176 494
1555 Acquisition and renovation of ICT-equipment	200 000	29 958	653 383	653 217
1557 Acquisition of non-depreciable values	0	0	10 000	8 835
156 Acquisition of intangible fixed assets	100 000	19 065	15 400	15 400

Revenue

The National Audit Office does not usually enter revenue in the budget.

Other revenue in 2005 is 12 250 kroons received as non-monetary targeted financing for training expenses.

Expenditure

Accrued expenses in 2005 were 35 431 417 kroons and cash-based expenses were 33 953 348.

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 2005, the Ministry of Finance allocated 298,972 kroons to NAO for writing off study loans.

Mihkel Oviir
Auditor General

Cash-flow statement

(in kroons)

	Note	01.01.2005–31.12.2005	01.01.2004–31.12.2004
Cash-flows from operating activities			
Operating result	11	-35 419 167	-33 708 646
Adjustments			
Depreciation of fixed assets	5, 6	2 074 994	2 200 340
Total of adjusted operating result		-33 344 173	-31 508 306
Net change in current assets		-22 114	-7 504
Net change in liabilities		201 380	121 455
Total of cash-flows from operating activities		-33 164 907	-31 394 355
Cash-flows from investing activities			
Paid at the time of acquisition of the fixed assets	5, 6	-1 087 413	-3 264 065
Total of cash-flows from investing activities		-1 087 413	-3 264 065
Cash-flows from financing activities			
Repayments of loans		0	-95 333
Paid interests		0	-3 042
Net financing from the budget	11	34 252 320	34 756 795
Total of cash-flows from financing activities		34 252 320	34 658 420
Net cash-flow		0	0
Cash and its equivalents as at 31.12.2004		0	0
Changes in cash and its equivalents		0	0
Cash and its equivalents as at 31.12.2005		0	0

Mihkel Oviir
Auditor General

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 by using the cost model. The cash flows of the core activity are drawn up by using indirect method. The cash flows of 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 entered by using the adjusted cost model. The claims on the balance sheet are entered at the time the right of claim arises and they are evaluated 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 on the balance sheet at the amount they are likely to be received. The claims received in the accounting period but previously written off are entered as the reduced cost of the claims unlikely to be received in the accounting period. Claims are deemed to be hopeless if the management finds that it is impossible to collect them. Hopeless claims are written off from the balance sheet.

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 30,000 kroons. Assets with a useful life of more than one year and with an acquisition cost of less than 30,000 kroons are entered 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 entered under the expenditure of the accounting period at the time they incur.

Mihkel Oviir
Auditor General

Fixed assets are entered at their acquisition cost from which the accumulated depreciation and the possible discounts resulting from the decrease in value are deducted. Two linear methods are used in the calculation of depreciation. Depreciation rate is determined separately for each object of the fixed asset, depending on its useful life.

Depreciation rates for fixed assets groups in a year are the following:

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

The assets whose useful life is more than one year and whose acquisition cost is at least 30,000 kroons are entered as intangible fixed assets. Intangible fixed assets are entered at their acquisition cost, from which the accumulated depreciation and the possible discounts resulting from the decrease in value are deducted. Intangible fixed assets are generally depreciated in 4 years by 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 entered as operational leases.

The assets leased on the basis of an operational lease contract are not entered on the balance sheet. The payments of operational lease are entered as expenses evenly throughout the lease term, irrespective of the period when the payments are actually made and of the amount of the payments.

An asset held under a financial lease is depreciated in the same way as acquired fixed assets, except in the cases where there is not enough certainty as to whether the lessee will acquire the ownership of the asset at the end of the lease term. In that case the assets are depreciated either during the lease period or the useful life, whichever is shorter. The financial lease payments are divided into capital repayments diminishing the payables and interest charges.

Accounting for taxes

Not recoverable 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 entered as expenditure at the time of the acquisition and they are excluded from the acquisition cost of the assets.

Accounting for revenue

Revenue is registered on an accrual basis.

Operations conducted in foreign currency

Operations conducted in foreign currency are entered 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 entered in the income statement as the profit and loss of the period.

Net financing from to state budget

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

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 2005, 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>31.12.2005</u>	<u>31.12.2004</u>	<u>31.12.2004</u>	<u>31.12.2004</u>
Tax and Customs Board	27 585	195 817	0	0
Other public sector entities	15 294	6 341	0	3 600
Total of state accounting entities	42 879	202 158	0	3 600
Total of associated bodies	14 849	20 142	0	0

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>Management</u>	<u>Management</u>	<u>Tax & fee</u>	<u>Tax & fee</u>
	<u>expenses</u>	<u>expenses</u>	<u>expenses</u>	<u>expenses</u>
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
State accounting entities	120 928	43 670	1 073 006	1 331 442
Associated bodies	135 045	165 651	0	0

In 2005, VAT formed 1 066 761 kroons and land tax expenses 6 245 kroons from the tax expenses.

Mihkel Oviir
Auditor General

Note 4**Other claims and advance payments**

(in kroons)

	31.12.2005	31.12.2004
Expenses of future periods paid in advance	129 922	104 472
Deductions from wages	1 300	4 636
Total of other claims and advance payments	131 222	109 108

The majority of the expenses of future periods paid in advance are the advance payments for periodicals in 2006 – 113 437 kroons (as at 31.12.2004, the advance payments for periodicals formed 97,945 kroons).

Note 5**Tangible fixed assets**

(kroonides)

	Buildings & civil engineer- ing works	Machinery & equipment	Other fixed assets	Total
Acquisition cost as at 31.12.2004	28 781 962	5 458 691	3 417 756	37 658 409
Accumulated depreciation as at 31.12.2004	-7 184 980	-4 233 358	-2 838 497	-14 256 835
Residual value as at 31.12.2004	21 596 982	1 225 333	579 259	23 401 574
Changes in 2005				
Acquisition and improvement of assets	867 587	140 000	41 427	1 049 014
Write-offs	0	-1 744 503	-400 109	-2 144 612
Depreciation	-846 888	-819 896	-347 161	-2 013 945
Reclassification of depreciation	0	1 744 503	400 109	2 144 612
Acquisition cost as at 31.12.2005	29 649 549	3 854 188	3 059 074	36 562 811
Accumulated depreciation as at 31.12.2005	-8 031 868	-3 308 751	-2 785 549	-14 126 168
Residual value as at 31.12.2005	21 617 681	545 437	273 525	22 436 643

Buildings and civil engineering works

The last stage reconstruction works of the ventilation and cooling system in the value of 867 587 kroons were registered in the accounting period as fixed assets. The project began in 2003. The cost of the works was 1 918 798 kroons in 2003 and 2 696 347 kroons in 2004.

Machinery and equipment

One printer was purchased in 2005.

During the year, depreciated IT equipment in the acquisition value of 1 744 503 was written off, out of which assets in the value of 948 904 kroons were destroyed (8 laptops, 2 PCs, 4 servers, 3 printers, 1 panel) and assets in the value of 795 599 kroons were transferred upon requests.

The assets transferred and the recipients were the following:

- MTÜ Taaskasutus – 9 PCs, 4 laptops;
- MTÜ Convictus – 6 PCs, 2 laptops;
- MTÜ Ohutuskeskus – 6 PCs.

Other fixed assets

41 427 kroons was spent on replacing the office furniture in 2005.

3 copiers in the value of 335 239 kroons, office furniture in the value of 38 232, a phone in the value of 16 638 and an overhead projector assembly in the value of 10 000 were written off as unserviceable assets. One depreciated overhead projector assembly unnecessary to the NAO was transferred to MTÜ Convictus following the latter's request.

Mihkel Oviir
Auditor General

Note 6**Intangible fixed assets**

(in kroons)

	Software	Total
Acquisition cost as at 31.12.2004	257 881	257 881
Accumulated depreciation as at 31.12.2004	-147 240	-147 240
Residual value as at 31.12.2004	110 641	110 641
Changes in 2005		
Acquisition of assets	38 400	38 400
Depreciation	-61 049	-61 049
Acquisition cost as at 31.12.2005	296 281	296 281
Accumulated depreciation as at 31.12.2005	-208 289	-208 289
Residual value as at 31.12.2005	87 992	87 992

A surveillance programme of the ventilation and cooling system, which enables to display operating signals, modes and set-points of the controllers, was purchased in 2005.

Note 7**Operational lease**

(in kroons)

	Payments		
	2004	2005	2006
Paid operational lease payments	137 228	96 725	61 406

In 2005, the NAO leased an automobile "Volvo" and a copier "Minolta" on the basis of operational lease contracts.

A commercial lease contract for an automobile concluded on 19.12.2001 was terminated on 07.04.2005. A new contract was concluded on 07.04.2005, ending on 15.05.2008.

The commercial lessor does not impose a fine on the NAO at the termination of the contract.

The lease contract for the copier expired on 30.11.2005 and it was returned to the commercial lessor.

Note 8**Arrears to suppliers and employees**

(in kroons)

	31.12.2005	31.12.2004
Arrears to suppliers	120 129	146 555
Arrears to employees	1 117 924	721 886

Arrears to suppliers are unpaid invoices for the services provided in December.

Arrears to employees are entered as holiday pay liability due in the value of 1 114 271 kroons and arrears for the mission and management expenses in the value of 3 653 kroons as at 31.12.2005.

Mihkel Oviir
Auditor General

Note 9**Taxes**

(in kroons)

	Tax arrears	
	31.12.2005	31.12.2004
Social tax	16 434	185 101
Income tax added to the fringe benefits	11 151	10 716
Total	27 585	195 817

Note 10**Management expenses**

(in kroons)

	01.01.2005–31.12.2005	01.01.2004–31.12.2004
Administrative expenses on reg. immovables, buildings and rooms	1 701 872	1 531 833
Administration expenses	1 392 141	1 348 785
Information and communications technology expenses	997 119	488 585
Mission expenses	698 324	870 682
Expenses on training tools and training	485 306	538 104
Expenses on the management of inventory	338 519	364 051
Vehicle maintenance expenses	256 118	314 031
Research and development expenses	144 357	73 850
Other expenses	25 358	11 923
Total of management expenses	6 039 114	5 541 844

Note 11**Net financing from the state budget**

(in kroons)

Cash transfers from the state budget	34 252 320
Received from the state budget for making transfers	34 279 733
Receipts transferred to the state budget	-27 413
Transfers from the income statement	35 419 167
Revenue accrued to the state budget as at 31.12.2004	22 557 065
Net transfer for transferring the difference in the cash and accrual accounting results to the state budget	- 1 166 847
Revenue accrued to the state budget as at 31.12.2005	21 390 218

Note 12**Grants awarded**

(in kroons)

	01.01.2005–31.12.2005	01.01.2004–31.12.2004
EUROSAI	7 323	7 323
INTOSAI	4 682	4 986
Total of membership fees	12 005	12 309

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

Note 13
Labour costs
(in kroons)

Remuneration costs	2005				2004	
	Graduated & basic salary	Additional & performance pay	Holiday pay	Grants & benefits	Total of remuneration costs	Total of remuneration costs
Officials						
Auditor General	461 976	92 389	90 792	40 849	686 006	623 398
Higher officials	4 497 598	1 214 777	690 129	782 314	7 184 818	6 714 357
Senior officials	6 488 109	1 557 491	1 187 162	1 401 039	10 633 801	9 311 002
Junior officials	258 132	7 402	16 366	25 154	307 054	650 897
Total of officials	11 705 815	2 872 059	1 984 449	2 249 356	18 811 679	17 299 654
Employees						
Workers and support staff	67 759	0	9 691	20 500	97 950	84 882
Total of employees	67 759	0	9 691	20 500	97 950	84 882
Temporary staff	127 200	0	0	0	127 200	207 736
Total of remuneration costs	11 900 774	2 872 059	1 994 140	2 269 856	19 036 829	17 592 272

Average number of employees	2005	2004
Officials		
Auditor General	1,00	1,00
Higher officials	22,87	24,76
Senior officials	49,94	49,06
Junior officials	3,13	5,07
Total of officials	76,94	79,89
Employees		
Workers and support staff	1,00	1,00
Total of employees	1,00	1,00

Fringe benefits	2005	2004
Write-off of study loans	170 840	422 000
Other fringe benefits	288 272	228 683
Total of fringe benefits	459 112	650 683

Taxes and social security contributions	2005	2004
Social tax on wages	6 282 661	5 807 109
Unemployment insurance premiums	90 274	84 772
Income tax on fringe benefits	152 563	237 050
Social tax on fringe benefits	209 775	300 872
Total of taxes and social security contributions	6 735 273	6 429 803

Remuneration to the management forms 2 869 584 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

3. Auditor General's speeches and replies to inquiries from Members of Parliament

3.1. On problems with use and preservation of state assets in 2004

Speech of Auditor General, Mihkel Oviir to the Parliament on 26 October 2005

Distinguished President of the Parliament, fine Members of Parliament,

13 years ago, your predecessors had the Estonian state budget for 1993 on their tables in this very same hall. I examined these old papers and when I saw the budget amount, my first thought was that I must be looking at the wrong figure. It was on a different scale, compared to the amounts we are used to now. The total budget amounted to EEK 3.7 billion. Now, 13 years later, it is hard to believe that we started from there. Nevertheless, the state has now reached a budget which is 15 times bigger than the budget determined by the then Government and Parliament.

What does it mean?

First of all, it means that the Estonian taxpayers have become wealthier. The living standard has improved, business has developed. Accession to the European Union has provided new impetus to Estonia. I can only rejoice at all this.

However, all these benefits must be accompanied by extreme caution – the greater the amount of money, the bigger the risk that it may be used in an improper manner; used for unreasonable purposes.

Or, in other words, one who is poor counts his kroons much more carefully than one who is rich. And Estonia, I believe, is rich. Of course, not compared to Scandinavian countries, for example. But compared to those countries which, after becoming independent, started out from the same kind of poverty as we did.

The more money there is, the more reason it requires to do something purposeful with it.

Two months ago I delivered to the Parliament the NAO's overview of the use and preservation of state assets in the preceding financial year. Since everyone has had the opportunity to examine it on request, I'll try to analyse concerns related to the use of money from a wider perspective.

The NAO is responsible for informing you of the problems. But solving these problems is the task of the Government and the Parliament.

All you fine people here today,

It is clear that misuse and foolish or irresponsible use of money is only a consequence. The problems that the NAO has pointed out for years have their roots in the attitude towards the taxpayers' money.

Just like I told you last year – it is not some abstract money belonging to the Government, the Parliament, or a Ministry. It is Estonian taxpayers' money and the Parliament is the highest governor of this money. In this context, I recall the old witch called Forest Hag from "Horned Boy". In a situation where Dumb and Dumber have found a mint want to divide the money straight away between everyone, the Forest Hag cooled the hot-headed bogeys and said: "Hold on, let's first count the money, and then we'll see if there's anything to divide!" The Parliament's role at the national mint is similar to that of the Forest Hag.

A sane person usually spends his money in accordance with the rules applicable in the family. These rules are very rational. For instance, I could not imagine a family which does not know its revenues and expenses and how much property it has.

Just the same, I could not imagine a father or mother giving their child a large amount of money just like that, without asking what it's for. Afterwards, the parents are sure to find out whether their offspring did buy a bicycle or did he spend everything on ice cream and candy.

Unfortunately, the Parliament and the Government are still far from being such a parent. It follows that in reality we have a situation where the state does not know exactly how much property it has or what its value is. And the taxpayers do not know exactly what the actual return for their money is.

As you all know, the explanatory memorandum of more than 700 pages to the state budget available to you does not have any binding implications as to the spending of money.

Since the Parliament has not taken any action to remedy the situation, some people might actually misbelieve that the Parliament doesn't care.

Distinguished Members of Parliament,

Most of the efforts of the Members of Parliament that came together 13 years ago and of their successors have been focused on legislative drafting – establishing the structural body of the state. Today, the material parts of this structural body are complete.

I believe that the time has come to start exchanging ideas as to the new possible priorities in the Parliament's work. The time and mental energy freed from legislative drafting could be increasingly spent on demanding answers from the Ministers and Secretaries General around the year as to how money is spent and whether it yields the results for which it was given.

Unfortunately, this kind of supervision does not currently work like in countries which we could set as examples. In countries like Finland, the United Kingdom, the Netherlands or Canada.

To promote good practice, the NAO has tabled a proposal to the Parliamentary Finance Committee to invite representatives like Secretaries General from all Ministries to appear before the Committee and report. To report on the spending of money, the quality of calculations and the legitimacy of transactions.

In turn, the NAO provides the Committee with its independent assessment on each Ministry. The Committee has given me positive feedback on this idea.

Ladies and Gentlemen,

The next agenda item is the first reading of the Government's Consolidated Annual Report on the preceding financial year. There is no doubt that a lot of effort has been put into compiling this extensive report. This is the very first time that the Government has been able to furnish such a consolidated report to the Parliament. For this we acknowledge the Government's Chief Accounting Officer, Jutta Maar who has conquered this challenging task of putting together the government accounts and aligning these with the international standards.

Although, this report does not connect activities with funds. One of the reasons for this is the state budget, which is not activity-based. The other is the problem with the management report, which in 2004 did not give a picture of the connections between the objectives set by the Ministries, their activities and the costs thereof.

The quality of government accounting has improved again, compared to the previous year, and this is of course is a good thing.

However, proper accounts should not be the reason for being especially proud. It is the most elementary requirement to be met.

Now, when we have a report covering the whole government, is the time to discuss how to make the most of the information in that report – on the executive and legislative levels.

I welcome the Ministry of Finance's intention to organise a thorough debate on the consolidated report at the beginning of next year, and the NAO will give its recommendations in this regard.

Dear audience,

Now we'll touch upon some issues commented in depth by the NAO in the previous year and earlier. First of all, about property, and more specifically, immovable property.

The state owns about 7,000 buildings and facilities. Unfortunately, I have to use approximate values, because this is still one of the areas with inadequate record-keeping. The deviation could be as much as hundreds of units.

According to the State Property Register, the state owns buildings and facilities with a total value of EEK 7.4 billion. According to the consolidated balance sheet of the state, the total value of government-owned buildings and facilities was more than twice as much.

In the State Property Register, the data are exaggerated, on the one hand, because the register recognises buildings which have been written off and demolished long ago and because it contains many double entries. On the other hand, there are many objects which the agencies have not entered in the State Property Register for different reasons. Thirdly, the value of objects does not conform to the reality, because the register includes many objects with zero value, which is not their actual market value.

In terms of accounting, the Ministry of Defence which inherited an enormous amount of Soviet military facilities has been the negative example for years. Just the same, I can't understand the situation where today, 13 years after the constitutional government commenced work, there is still no uniform and consolidated list of acceptable quality of objects administered by the Ministry of Defence.

In this context, I acknowledge the former Defence Minister Jaak Jõerüüt who drew attention to the problem and took active measures to fix the problem. I hope that his successor Jürgen Ligi will complete this task. By the way, a couple of months ago the Ministry of Defence found seven more buildings in the City of Tartu which were not accounted for.

Honourable Parliament,

The Government still has no integrated, supra-ministerial real estate policy. Also, there are no development schemes to ensure that investments in buildings and facilities are justified and create value in the future as well.

Thus it is still possible that millions could be wasted on buildings which are really not necessary for exercising state authority. The lack of clear decisions and development plans gives rise to setbacks in all fields.

The NAO has continuously reiterated that the government should possess only property necessary for the performance of its functions. The rest should be transferred to local governments, sold, or demolished, so as to avoid littering the government accounts and emptying the treasury.

One of the alternatives is transferring the unnecessary buildings to the public limited company Government Real Estate (GRE). However, GRE is not interested in these, because they do not yield profit. This leads us to the cluster of problems relating to GRE.

When this public limited company was established 4 years ago, I was a Secretary General at the Ministry of Justice. I strongly supported the establishment of that company. Why? Because almost half of my working time as a Secretary General was consumed by real estate issues – somewhere is a roof

leak, somewhere a court house is about to collapse, somewhere a wall of a prison facility has grown thin enough to let light in, and so on, and so on.

And then, Siim Kallas presented his vision of how to consolidate the management of all state-owned immovable property in a single company and to relieve the public authorities from such concerns. I thought back then and I still think that the idea of relieving the public authorities from ancillary functions and consolidating all the activities concerning real estate is the right idea.

However, the problem occurred as usual in Estonia – things are left pending. Good ideas are spoiled, because the state is unable to implement these in full – the executive branch is weak. This is what happened with GRE.

The Ministries were given too much discretion, a single and generally applicable system was not introduced. The result is that only 3 Ministries out of 11 have transferred property.

There is discontent that certain services provided by GRE are too expensive, etc. The accusations have been targeted to GRE.

I believe that this is not quite fair. The accusers forget that the problem was programmed in the system from day one. If GRE improves buildings, the rent will be increased by the amount of the investment, because the consumer of the benefits must pay for it. This is normal.

Transition the GRE system did not take account of the fact that if all state-owned real estate is improved quickly and at the same time, the rent and thus the Ministries costs increase a lot.

This system presumes that each year the state budget accommodates an amount to cover the growing rent. And that this money is a concrete expenditure item not to be overlooked.

This means that the current system can be maintained in operation. To this end, the pace of improving all state-owned real estate must be determined. The pace must be such as not to tear the budget apart.

The Ministries cannot be given uncontrolled authority to make agreements with GRE, instead, a nationwide plan must be prepared for several years and adhered to.

Often, the GRE has been accused like “oh, awful, they are looking for profit”. I draw the attention of those accusers to the fact that the GRE is a company and the inherent purpose of a company is to make profit.

Whether the state should use a state-owned public limited company to manage its real estate is a completely different issue. Maybe it would be more suitable, if the company was replaced by an administered government agency or a department of some Ministry. Or is a public limited company still the best form? We'll have to wait to find out.

Anyhow, the Ministry of Finance has promised to carry out a thorough analysis of the entire real estate policy of the state in November. I believe that the government will be able to answer the question whether the buildings should be owned by GRE or should only the management services be outsourced. Which model will the state choose for managing its real estate?

Furthermore, a public company does not decide independently, the Management Board is guided by the instructions of the Supervisory Board. The Supervisory Board plans the company's business, arranges its management and supervises the activities of the Management Board.

GRE has a Supervisory Board as well and the former and current members of that board are sitting in this hall right now. You have the power to direct the company. Make use of this opportunity. Or have some decisions of the Supervisory Board been ignored?

Dear audience,

The SAO finds that the issue of responsibility of Supervisory Boards of public companies is of utmost importance. This responsibility should be specified and extended. However, I have not come to notice any substantial progress in this regard. As the representative of the owner, the Supervisory Board is responsible for strategic management, economy and the management of any risks.

I underline – responsibility is a key issue in all public offices – responsibility should be detailed for each duty. Currently, this approach has been avoided.

Therefore, we don't know who is responsible for wasting hundreds of millions of taxpayers' kroons on projects like Werol. The business of the public limited company "Animal Waste Treatment" seems to entail irresponsibility as well. Nobody seems to be responsible for the problems and miscalculations related to this company, which the people call carrion factory.

I don't recall any cases where the state has sued an official whose stupidity or irresponsibility has entailed financial losses for the state. By which right has the state left this money uncollected?

Distinguished Members of Parliament,

The dispersion of responsibility strikes back especially in areas where supra-ministerial problems occur. In Estonia such problems are amplified where co-operation is required from Ministries the heads of which belong to different political parties.

The so-called 11 kingdoms effect is spreading – individual Ministries conduct business as they see fit and do not tolerate anyone entering their playground.

The so-called sugar penalty case can also be attributed to insufficient co-operation between Ministries. The Ministry of Finance and the Ministry of Agriculture tossed the sugar issue back and forth. I'd rather not deal with this issue in detail, because it makes me sour. On 7 November, the NAO sugar audit will be open for public debate in the Parliamentary Committee for State Budget Audit.

I agree fully with the Prime Minister Andrus Ansip who said that the sugar case must be learned from. I think that the government must conduct a thorough analysis with a view to the issue of supra-ministerial capacity. Especially as regards the use of EU funds.

An area which well reflects the 11 kingdoms policy is IT development. Indeed, Estonia is recognised around the world as country which has successfully harnessed IT and computers. Recently, Estonia showed the successful e-voting to the world.

The NAO, however, has examined how this Estonian success looks from inside. The conclusion is that our IT tiger's impetus and ability to jump tends to wither away. The reason is the insufficient co-ordination of the IT field.

The Government of the Republic Act does not refer to any specific Ministry as being responsible for the comprehensive development of IT. Plus, the state does not have any idea of the actual expenditure on IT. Just the same, it is not certain that funds allocated for IT are used optimally.

This is where your predecessors stabbed us in the back. They were the ones to amend the State Budget Act so that starting from 2003 the Treasury is unable to give a picture of the actual IT expenditure of the public sector. The previous composition of the Parliament included IT expenditure in the management expenses of the Ministries. Up to 2002, IT expenses were listed as a separate item in the state budget.

To maintain and further Estonia's reputation as a successful IT country, the systems must be put to serve the citizens so that people would clearly feel the advantages.

Yes, we have some outstanding projects like e-Tax Board, but there should be more and they should be interrelated.

It is absurd that a person must hurry from one agency to another in order to deliver the paper copy of data printed from the IT system one agency to another where these are entered in the latter's IT system. E-government does not mean merely that an official's computer is connected to the Internet.

It should not be that each Ministry develops its own systems, duplicates efforts and spends millions on similar results.

For instance, the government uses about 30 different accounting programs. When will we get to a single program? Or when will we get to a situation where all government accounting can be monitored online for all agencies?

I welcome that fact that the Government Information Systems Department of the Ministry of Economic Affairs and Communications has outlined a plan for integrating the public sector information systems into a single logical entirety serving the people and organisations. I hope that this plan will not be halted by dissenting opinions.

Let's start from small steps. The famous electronic system for government sessions is an excellent piece of work, but the Ministries' unwillingness to keep up with the developments has forced us to use this very good system in a prehistoric manner.

It is probably because the Ministers and Secretaries General still like to admire their signatures on paper. It follows that the Ministry drafts its documents in a computer, but then prints them out, has them signed and sent to the State Chancellery. There these papers are scanned like photos into the computer and entered in the electronic system for meetings. This is absurd. Please use digital signatures!

I am glad to learn that the Prime Minister Andrus Ansip announced a week ago at a press conference that 1 January 2006 is the day from where on no paper documents will be used at government meetings. The NAO makes the transition to electronic correspondence already from December and therefore I call on all government agencies to do the same. Let's make signatures digital.

Dear audience,

Reasonable use of taxpayers' money should start from this hall. Therefore, I call on the Parliament to consider the possible measures to better protect the taxpayers' interests.

I invite to discuss the issue of responsibility between the Minister and the Secretary General. Based on the NAO work experience I am convinced that responsibility for accounting, inventory and legitimacy of transactions must clearly and unambiguously lie with the Secretary General.

This ensures the consistency of responsibility and is reasonable both in theory and in practice. I remind you that, for example, the Ministry of Defence has already the third Minister within one year. The Ministry of Economic Affairs could have already the fourth Minister within one year.

For conclusion: both politicians and officials must understand that the money they handle and for the prudent and rational use of which they are responsible is not their or the agency's or the Ministry's – it is the common money of us all, the taxpayers' money.

If awareness of this responsibility is increased, the people will feel that the state is for everyone and that the taxpayers' interests are given priority. This way the people feel that our country is firmly developing and improving. Faster and honestly.

Rationality in handling money and future-oriented decisions are strictly necessary, because we are not here temporarily, we live here.

Thank you for your time!

3.2. Auditor General's replies to written questions concerning the rental contract made between the North Police Prefecture and AS Kalev in 2003 and the rental contract made between the South Police Prefecture and AS Tartu KEK in 2004

Reply to the written question of Andres Herkel, Member of Parliament

Honourable Mrs. Ergma,

Andres Herkel, Member of Parliament addressed me under § 147 of the Parliament Rules of Procedure Act written questions concerning the rental contract made between the North Police Prefecture and AS Kalev in 2003 and the rental contract made between the South Police Prefecture and AS Tartu KEK in 2004. The questions read as follows:

- 1. Were all legal requirements respected in entering into the above rental contracts?**
- 2. How do you comment suspicions that the said rental contracts are disadvantageous for the state? Do you consider these contracts to be disadvantageous or advantageous for the state?**
- 3. What are your suggestions to avoid further rental agreements that are unfavourable for the state?**

I am glad to find out that such an important issue like government real estate, including the management of office spaces, is of serious concern to the Members of Parliament. I have drawn attention to these problems in several years and noted in the overview of use and preservation of state assets in 2004 just presented to the Parliament that improvements come slowly. The government lacks a clear real estate policy, and therefore putting the transactions you mentioned in a general context and the related assessment is quite difficult.

In brief, the rental contracts case is as follows: On 28.01.2003, the Tallinn Police Prefecture and AS Kalev made a rental contract for business premises for a period of 20 years. According to the contract, the company leased to the Prefecture non-work and administrative rooms in a production facility located at Pärnu mnt 139 together with the parking land belonging thereto. The total area of leased rooms was 8,000 m² and the rent amounted to EEK 150/m² per month. The rent included management and maintenance of the building and keeping the premises clean. In addition, there was an obligation to pay for utilities (water, sewerage, electricity, heating, etc) on the basis of actual costs.

On 11.03.2003, AS Kalev entered into a contract of sale with right of repurchase under the law of obligations for selling a legal share of the registered immovable located at Pärnu mnt 139 to OÜ Raldon for EEK 87 million. Thereby, the buyer assumed the obligation to invest up to EEK 90 million in improving the new premises of the Tallinn Police Prefecture.

Under Government Order No. 620-k "Authorisation to enter into a contract" of 02.10.2003, the Police Board and OÜ Raldon made a new rental contract on 03.10.2003 setting out that the total rented area is 14,000 m². The contract stipulates that the amount of rent is EEK 172/m² per month during 01.01.2005-01.01.2008. From 01.01.2008 onwards, the rent may be increased annually on the basis of the consumer price index, but not more than 3 % per year. The rent includes the cost of furniture, real estate maintenance, utilities and the fee for parking lots on the premises. It is not possible to separate individual components. OÜ Raldon was to carry out the reconstruction work on its own account, according to an annex to the lease contract concluded with the Police Board beforehand. The contract also stipulates that if the rent contract will be terminated within the first 5 years, the tenant shall pay a contractual penalty equal to 5 years' rent less the total amount of rental payments settled by the tenant as of the day of withdrawing from the contract.

Under Government Order No. 529-k of 08.07.2004, the decision made on 03.10.2003 was amended and the Police Board was granted the authorisation to rent a further 2,000 m² from OÜ Raldon at

Pärnu mnt 139. Government Order No. 530-k of the same date allowed the Border Guard Administration to rent 3,300 m² from OÜ Raldon at Pärnu mnt 139 for 20 years. Both contracts were made under conditions similar to the previous ones and the rent was set at EEK 150/m².

The other contract mentioned in your letter was signed under Government Order No. 847-k „Authorisation to enter into a contract“ of 19.12.2003. The Police Board was granted authority to make a rental contract with AS Rondam for a period of 20 years for using a total area of 8,844 m² in Tartu at Riia 132. The contract was concluded under conditions similar to those of the Police Board's earlier contract concerning Pärnu mnt 139 in Tallinn and the price per square metre was set at EEK 162.5 for the period 2005-2006. From 2007 onwards, the landlord can adjust it on the basis of the consumer price index, but not more than 3 %. The contractual price includes use of furniture and all real estate maintenance services, but excludes support and communication services.

I point out that at the time of granting authority to enter into the said contracts the Ministry of Finance submitted its dissenting opinion. The Ministry noted that a public procurement procedure or a competitive tender should have been announced to get better lease terms (although the Public Procurement Act does not expressly require it). It was also noted that the contract does not specify the support and communication services not included in the rent and that the contract should provide for the possibility of termination before the expiry of a 5-year period without contractual penalty. Nevertheless, the Cabinet of Ministers authorised the Police Board to sign the contract.

In reply to your questions, I can say the following at the moment:

1. Unfortunately, the 10 days granted for replying to the question is not enough to make an in-depth analysis and to draw conclusions as to whether the contracts were made in compliance with all laws and whether the said contracts are disadvantageous or favourable for the state. What needs to be analysed in more detail, are the events in 2003, including which other options were considered and why the decisions in favour of these contracts were made and whether the Government was forced to grant the authorisation to sign the contract for Pärnu mnt 139, because the previous contract already set out that obligation. Also, other alternatives available then must be analysed: services rendered by PLC Government Real Estate ("GRE") (or another company), construction of a new office building or renovation of the existing one. The deadline for reply is also too limited for determining the current potential rent price of these facilities on the free market and comparing it to the rent currently paid.

2. The rent price in the contract with OÜ Raldon includes, besides rent, the cost of furniture and fees for maintenance and utilities. Since these cannot be separated from the final amount, comparing only the rent price with the free market prices (market prices of EEK 140-180/m² without VAT and utilities, GRE offers ranging from EEK 60 to 180 per m²) can lead to the wrong result. The contract with AS Rondam does not allow determining the final cost burden of the Police Board. Price comparison and determining the possible market price requires a deeper analysis and involvement of real estate experts. Only after an in-depth analysis it is possible to give an opinion on whether the amounts to be paid in 20 years (a total of about EEK 1 billion) constitute the most economic way of management serving the taxpayers' interests as compared to the erection of a new building or renovation of the existing one.

3. Currently, there numerous examples of transactions where a company which owns the building assumes the renovation and maintenance obligation and leases it forward (or back) to the government at the market price. This is not a question of legitimacy of transactions but rather of whether the state should own the property itself or not. Should the government work in the same conditions as a prospering company? Is the government rich enough to pay market prices for its office spaces now and in the future? Is the average usable space of 5-38 m² per government official reasonable in a situation where the private sector makes do with 5-17 m²?

These are questions that the government itself should answer. At the moment, basically all transactions are allowed and the public authorities' willingness to economise is not recognisable. For years, the Ministers of Finance have promised to develop office space standards, but there are still none.

Furthermore, I am worried about the new Government Property Act, which the Government intended to put into effect on 01.01.1006, but which it still hasn't even discussed. This means that a law of fundamental importance is not put into effect at the planned time.

I still maintain that the government must formalise the state's real estate policy. The state should own only the property that it needs to perform the functions of a state. Office spaces should be selected with regard to the principles of reasonableness and economy.

3.3. Auditor General's reply to the inquiry from the members of the parliamentary faction of Isamaaliit pertaining to the so-called sugar penalty

In the Parliament, on 16 October 2005

Honourable President of the Parliament, distinguished Members of Parliament,

On June 20, Parliament Members Andres Herkel, Mart Laar, Tõnis Lukas and Peeter Tulviste sent me an inquiry composed of four questions. The inquiry related to the NAO audit "Efforts of the public authorities of Estonia to avoid generation of surplus sugar stock by the time of acceding to the European Union". The NAO disclosed that audit report in the beginning of June and all Members of Parliament received this nearly 200-page material.

The audit was motivated by an inquiry addressed to the NAO by the Parliamentary Committee for State Budget Audit. In the light that inquiry, the purpose of the audit was to find out why the government failed to or didn't consider it expedient to take effective measures to avoid the generation of surplus sugar stocks and the potential costs it might cause.

Before answering the questions, I remind you that according to the current estimates Estonia should pay about EEK 1 billion for surplus stocks, where of EEK 700 million for sugar.

1. The audit report demonstrates that the generation of surplus stock could not be avoided because of inadequate actions of the government. The report shows that the whole Cabinet of Ministers is at fault. Do you think whether it is possible to subject the Members of the Cabinet of Ministers to civil or criminal liability, in addition to political liability?

Our audit did not try to answer the question whether in Estonia it is possible to subject politicians to civil or criminal liability in addition to political liability. Replying to this question, which is largely legal-theoretical, is not in Auditor General's competence.

2. Paragraph 10 of the material conclusions of the audit report shows that the Ministry of Agriculture acknowledged the letter from the DG Agriculture of the European Commission drawing attention to the risk of generation of surplus sugar stock only during the NAO audit, although Estonia's Representation at the EU had received the letter in August 2003. Did the audit reveal who is responsible for the Ministry of Agriculture acknowledging with a considerable delay the letter from the DG Agriculture of the European Commission drawing attention to the risk of generation of surplus sugar stock?

Firstly, which letter are you referring to? Since in many acceding countries the sugar stocks had started growing, the Director General of DG Agriculture and Rural Development of the European Commission, Jose Maria Silva Rodriguez drew the attention of acceding countries to the need to prevent the creation of stocks for speculation purposes and to make the businesses generating stocks aware of the fact that surplus stocks must be eliminated. The Director General's letter includes a subparagraph stating that the aim of communicating the information is to allow the authorities to prevent the generation of speculative stocks and inform the companies supplying sugar of the risks.

Since it was not a routine letter or memo, but a communication from the Head of the DG, the management of the Ministry of Agriculture should have been informed thereof. As far as we know, this letter didn't reach even the Ministry's heads of department.

According to the explanations given by the Head of Estonia's Permanent Representation at the EU, the letter was delivered to an employee of the Ministry of Agriculture who worked as an attaché at the representation and who should have notified the Ministry thereof. We were unable to ascertain whether the letter was forwarded to Estonia, and if so, where had it disappeared. According to the attaché's explanations he is not required to register the faxing of documents. However, the Rules of Procedure of the Ministry of Agriculture require that all faxes sent by the attaché must be registered,

but mostly it was not done. The Ministry's Secretary General explained that the faxes were not registered because at the material time - in summer 2003 - an enormous amount of papers arrived from Brussels!

Talking about the letter is necessary, because it points out material deficiencies in the procedural management of public authorities. The audit in question revealed similar shortcomings in a number of other cases.

3. Paragraph 5 of the material conclusions of the audit report shows that the Surplus Stock Charge Act could have been adopted earlier. Did the audit ascertain the authorities or persons whose actions (or omissions) caused the Surplus Stock Charge Act to be prepared and enacted too late?

I repeat our position in this issue.

Both the then Minister of Finance and the then Prime Minister have argued that the draft of this Act couldn't have been submitted to the Parliament any earlier. But it could have been!

The European Commission had laid down the criteria for declaring stocks as surplus and charging for such stocks already in the beginning of November 2003. The fundamentals of that Regulation were known to our officials several months before its adoption. If the government coalition had been unanimous, the draft of the Act necessary for the implementation of that Regulation could have been submitted to the Parliament already in 2003, and in case of willingness to do so the Act could have been adopted in January 2004. The Act would have established the necessary clarity as to stocks.

The Commission's so-called Sugar Regulation of January 2004 supplemented the Commission Regulation of November 2003 nothing more than the possibility to withdraw sugar stocks from the market, i.e. it did not create new restrictions for the businesses. If we had already had the Surplus Stock Charge Act, only a few changes should have been made to it following the adoption of the Commission's Sugar Regulation of January.

Dear audience,

You probably ask why the draft Act reached the Parliament only in February 2004? This is because the government reached a consensus on its necessity only on January 29, 2004. From October up to the said date the Ministry of Finance and the Ministry of Agriculture wrangled with each other, because neither wanted to assume responsibility for that issue.

The Minister of Agriculture explained the European Commission's requirements to the government and highlighted the provision in the Commission Regulation that the state must subject the businesses' surplus stocks to tax. Until mid-January 2004, the Minister of Finance was of the opinion that it must not be done.

This means that the Minister of Finance delayed the necessary decision. However, the Minister of Finance could not have in any way prevented the Minister of Agriculture from drafting and submitting to the government for discussion the legislative draft necessary for implementing the Commission Regulation. The Minister of Agriculture did not do that. And whether the Prime Minister would have put this issue on the agenda against the Finance Minister's will is yet another aspect.

Therefore, to sum it up, my reply to this question is as follows: the legislative draft was delayed largely because the Minister of Finance did not accept the proposals of the Minister of Agriculture and the latter did not present these to the other Cabinet Ministers convincingly and specifically enough, meaning that he did not submit a draft Act.

4. The Parliament adopted the Surplus Stock Charge Act on April 22, 2004 and it entered into force on May 1 of the same year. Do you think that adopting that Act in such form was in accordance with the Constitution?

First of all, a small correction: the Parliament adopted the Act on April 7, on April 22 the President proclaimed it.

The legislation's compatibility with the Constitution is judged by the Chancellor of Justice, this is not in the NAO's competence. I forwarded this question to the Chancellor of Justice and on August 11 I received a written response.

The Chancellor of Justice replied that in 2004 he processed three petitions challenging different provisions of the Surplus Stock Charge Act. All these petitions concerned, among other things, the compatibility of that Act with the principle of legitimate expectation. In his replies to the petitioners, the Chancellor of Justice does not mention that the Act would be in conflict with the Constitution or other legislation.

These replies were forwarded to me accompanied with a note that the opinions of the Chancellor of Justice remain unchanged.

Thank you for your time!

3.4. Auditor General's reply to an inquiry of 29.09.2005 from Parliament Member Peeter Kreitzberg

In the Parliament, on 14 November 2005

Honourable Chairman, distinguished inquirer, dear Members of Parliament,

On September 29, Peeter Kreitzberg, a Member of Parliament addressed to me a written question and an inquiry concerning the lease of premises to the Tallinn Police Prefecture, the Police Board and the South Police Prefecture in 2003. We replied to the written question on October 14 this year and today I respond to the inquiry.

To this end, the NAO analysed the rental contracts mentioned by the inquirer and collected information on the economic analysis and negotiations preceding their conclusion. The chronology of events alone consumed almost 50 pages.

It has to be noted that a considerable part of analysis and debates, if any, on the justification of renting rooms has not been recorded in writing

In the daily newspaper Postimees of 26 October 2005, the Minister of Internal Affairs argued that his Ministry has repeatedly analysed the terms and conditions of contracts concluded for renting about 20,000 m² for the Police Board, the Border Guard Administration and the North Police Prefecture, and has found these to be representative of the market situation and favourable for the state.

The NAO requested the Ministry of Internal Affairs to produce the said analyses. The reply was that these analyses have been conducted in oral form.

The arguments are said to be listed in explanatory memoranda. The said memoranda are, however, of general nature and contain no substantive analysis.

Therefore, the information on the economic justification of renting premises is fragmented, consisting mostly of the memories, explanations and letters of the parties involved.

Dear Members of Parliament, the non-transparency of the process inevitably arises suspicion that the decision to rent the rooms was not made in public interests and that the taxpayers' money has not been used economically.

1. Do you find it reasonable not to apply public procurement procedures for such costly and long-term rental contracts?

If the lessee had announced a public tender, it would have considerably eliminated the current doubts and formally precluded the possibility that the decision to lease is harmful for the state or unduly favours a certain company.

However, being familiar with the practice, it has to be admitted that the announcement of public tender or competitive bidding is not always enough to find the economically most viable solution. It would have been advisable to announce a public tender for leasing rooms for the police, but it would not have precluded the need for written economic analysis.

If we want to assure the public that at the material time the option chosen from the ones available to the state is the optimal one:

- the agency's need for space;
- different alternatives;

- the criteria for choosing among the alternatives; and
- the justification of the choice made must be in writing.

In the wider context, damage has already been caused by suspicions arising from non-transparent procedures, because the public's confidence in the state has been compromised.

2. Has the state suffered from financial losses because of entering into the said rental contracts?

In plain language, financial loss has been created if the agency's effective space need has been satisfied by choosing from the available options the one which is not the most economical.

Firstly, let's go over the simple and logical framework of the economic justification analysis in the light of the issues concerned.

For starters, it must be analysed, in a form allowing reproduction, whether it is necessary to relocate the agency and how urgent is this need. Next, the space need must be determined: how much and which space the agency needs.

When comparing the alternatives for satisfying the space need, the first logical solution would be using a state-owned building.

If the state does not have a suitable facility, the next options can be considered.

Of course, it is in principle possible to construct a new, custom-made building by means of state budget resources. Assessment of the total cost of this solution must take account of the planning, design, furnishing, equipping, maintenance and other expenses. A variation of the same alternative is to build it yourself by means of a loan. In this case, the costs must include loan interests. The third option is to build or renovate a suitable facility with the help of Government Real Estate PLC ("GRE"). In this case, GRE remains the owner of the building, unlike for the above alternatives. Not given the other conditions, the further end of the cost-benefit scale accommodates the option of renting a building from the private sector.

Before opting for this alternative which is most expensive for the state, at least theoretically, the use of above alternatives, which are less expensive for the state, should be precluded on acceptable grounds.

The option of leasing from a company has been used for acquiring almost 20,000 m² of space for the Police Board, the Border Guard Administration and the North Police Prefecture and almost 8,600 m² for the South Police Prefecture.

Now, let's put the known facts in the above-described framework of analysis.

Firstly, Tallinn

In summer 2002, the provisional space scheme of the common complex of buildings for the Tallinn Police Prefecture, the Harju Police Prefecture and the Police Board was drafted on the basis of the Police Board's activity plan for 2002. It stated the need for 10,385 m² of space. The complex was to be erected at Rahumäe tee 6. The space scheme was forwarded to GRE for an estimate of the cost of the complex, the rental price and the potential timetable of design and construction. The GRE has not given an official reply to this address by the police.

Now, we'll look into determining the possibilities of renting buildings.

In Tallinn, on October 3, 2003, Robert Antropov, representative of the Police Board and Mati Tusovi, representative of OÜ Raldon signed a rental contract for leasing 14,000 m² of space for the Police Board and the North Police Prefecture at Pärnu mnt 139.

This contract was supplemented on 8 July 2004 by an annex to the rental contract of the Police Board signed by the same persons in order to lease additional 2,000 m² for the Police Board and the North Police Prefecture at Pärnu mnt 139. The NAO compared these contracts with the imputed price level offered by GRE and commissioned expert assessments from OÜ Uus Maa Kinnisvarakonsultandid and OÜ Ober-Haus Hindamisteenused and to determine the fair rate of rent for the facility and from OÜ Uus Maa Tartu büroo for the buildings in Tartu.

Here, I point out that the price level offered by GRE is imputed on non-comparative basis.

On 24 September 2003, GRE sent its offer on the basis of the space scheme delivered by the Ministry of Internal Affairs in August of the same year. Back then, it concerned 5,615 m² of space. In GRE's offer the rent was EEK 75/m² plus maintenance charges, cost of furniture and VAT. When including the said costs to the rental price to make the price comparable as to components with the rent charged by OÜ Raldon, the rent would have been EEK 147.5/m². GRE's offer would have excluded utilities, which in OÜ Raldon's offer are included in the rental price. Therefore, GRE's offer would have been equal to that of Raldon's, if not more expensive.

On 25 September 2003, i.e. one day after receiving the offer from GRE, the Cabinet of Ministers discussed the draft Government Order „Authorisation to enter into a rental contract with OÜ Raldon". In the rental contract submitted to the Cabinet, the rental price was EEK 157/m². The rental price includes VAT, cost of furniture and all activities related to real estate maintenance, but not support and communication services which are payable by the lessee on the basis of direct contracts between the service providers and the lessee. The rental price includes utilities.

On 2 October 2003, the Cabinet of Ministers authorised the Police Board to enter into a rental contract for a total space of 14,000 m² for a period of 20 years on the following conditions:

- from 01.10.2003 to 31.12.2004, the rental price will be EEK 157/m²;
- from 2005 to 01.01.2008, the rental price will be EEK 172/m²;
- from 01.01.2009, the landlord may increase the rent once a year on January 1 on the basis of the changes in the national consumer price index published by the Statistical Office of Estonia, but not more than 3 % per year.

The rental contract was signed under the conditions set out in the Government Order.

On 8 July 2004, the government authorised the Police Board to rent a further 2,000 m² at Pärnu mnt 139. The government accepted that:

- from 1 July 2004 to 31 December 2008, the rental price will be EEK 150/m²;
- from 01.01.2009, the landlord may increase the rent once a year on January 1 on the basis of the changes in the national consumer price index published by the Statistical Office of Estonia, but not more than 3 % per year.

The Government Order does not reflect the contractual condition that in connection with the additional investments to be made by the landlord the state is required to pay the rent for all the rented spaces in the said building for at least 11 years.

The above comparison shows that the rental price in the contract made with OÜ Raldon is rather favourable for the state. However, it should be kept in mind that the entire building was leased for a long period and this benefits the landlord as well.

Honourable Chairman, as I understand, my time is up. I apologise to the Members of Parliament and the inquirers, because the list of facts is very long and I wanted to bring it to you as precisely as possible so as to avoid any possibility of two-minded opinions.

Thank you for your time!

Due to elapsing of the time provided for replying to the inquiry, the following part of the reply was not presented:

Annually, OÜ Raldon must be paid EEK 32.7 million for the rooms rented in Tallinn to the North Police Prefecture and the Police Board.

According to the real estate experts, the net rental price of the office building at Pärnu mnt 139 ranges from EEK 120 to 140/m². VAT and furnishing, utility and real estate management and maintenance costs will be added to the price. The current rent is EEK 172/m² per month.

The NAO asked the real estate experts to estimate the potential cost of constructing a new administrative building for the police in Tallinn (given the space need of 16,000 m²). The experts believe that currently the construction cost of this building would be EEK 210-250 million. The costs of acquiring a plot would have to be added. The experts find that in 2003 the construction cost would have been EEK 176.6 million.

Contracts in Tartu

On 21 January 2004 in Tartu, Robert Antropov, representative of the Police Board and Kersti Seli, representative of AS Rondam signed a rental contract for leasing 8,200 m² of space at Riia mnt 132 in Tartu to the South Police Prefecture. This contract was modified on 2 August 2005 by increasing the rental space to 8,574 m².

In July 2003, the Tartu Police Prefecture sent letters to OÜ Uus Maa Kinnisvarakonsultandid and OÜ Fantico, and GRE requesting information on the availability of potential rental spaces suitable for the police. The letters set out the benchmark data established by the police.

On 19 August 2003, the then Director General of the Police Board, Robert Antropov set up a committee for renting, to meet public service needs, a suitable complex of buildings in the City of Tartu for the South-Estonian Police Prefecture to be established. The committee's functions included:

- to evaluate the offers for rental spaces submitted on the basis of benchmark data established by the Tartu Police Prefecture and to determine the best offer;
- to conduct negotiations with the successful tenderer and to prepare the drafts of the rental contract to be made with the successful tenderer and of the financing application.

The committee examined nearly all submitted offers. The premises were inspected, the space inventory drawings and the plans of plots were examined. Having reference to:

- the location requirements – this means accessibility by car and public transport, distance from detention house, connection routes for operational vehicles with regard to different city districts, the electronic and technical communication possibilities;
- the criteria for functional suitability of premises – the amount of effective space, office space, parking area for 250 vehicles, car repair complex, auxiliary rooms;
- the time factor – given the fact the new premises are needed as from the beginning of 2004;

the committee found that the most suitable object for opening negotiations is the property at Riia mnt 136 offered by the real estate agency Uus Maa.

On 27 October 2003, GRE delivered its offer on the basis of revised need for rental space of the South Police Prefecture notified by Robert Antropov on October 3 of the same year. The offered rate of rent was EEK 166.38/m². The rate offered by AS Rondam was EEK 162.5, including the gym and shooting range equipment. Thus, Rondam's offer was more favourable than GRE's. The real estate experts find that the net rent for such office building ranges from EEK 90 to 120/m². VAT, utilities, furniture and real estate management and maintenance would be added to the net rent. Annually, EEK 16.1 million is to be paid as rent.

The experts think that currently the cost of erecting in Tartu a new police building with a space of 8,800 m² ranges from EEK 95 to 105 million, depending on the quality of finishing. At the prices of July 2003, the cost would have been EEK 80 million.

There are some other details related to leasing premises for the South Police Prefecture in Tartu. In connection with moving to the new building, the South Police Prefecture cancelled prematurely the contract for renting rooms in Tartu, Raekoja plats 9. The landlord, OÜ Fantico filed an application to the court to declare the termination of the contract unlawful. The Tartu County Court satisfied OÜ Fantico's action in part. The County Court upheld the nullity of the exceptional notice of cancellation of the rental contract made between OÜ Fantico and the South Police Prefecture on 9 April 2000 and the validity of the rental contract, and dismissed OÜ Fantico's action against the South Police Prefecture to require the latter to comply with the contract. A month ago, the Tartu Circuit Court dismissed the appeal and upheld the judgment of the Tartu County Court.

Due to moving to the new administrative building, the former office buildings of the South Police Prefecture which are still state-owned are standing empty - Vanemuise 64 and Tiigi 67. Their heating and maintenance and electricity causes expenses to the state.

Under Government Order of 19 December 2003 the Police Board was authorised to enter into a rental contract for 20 years for using a total space of 8,844 m² at Riia mnt 132 in Tartu on the following conditions:

- 1) from 1 May 2004 to 31 December 2004, the rent per square metre is EEK 145 per month;
- 2) from 1 January 2005 to 31 December 2005, the rent per square metre is EEK 162.50 per month;
- 3) the rental contract may provide for the right to adjust the rental price from 1 January 2007 once a year on the basis of changes in the consumer price index published by the Statistical Office of Estonia, but not more than 3 % per year.

For conclusion

I reiterate the fact that the government's real estate policy allows transactions harmful for the state, but the lack of a long-term real estate program forces the agencies to find solutions on their own in some cases. It is very hard to believe that there were no other options besides renting. However, it is difficult to determine afterwards whether there were other available options.

3. Do the described examples provide the public with assurance that the public sector funds are used legitimately and efficiently?

The public could be given assurance that the state budget means have been used purposefully and economically, if leasing or constructing buildings for public authorities would be preceded by a documented analysis of economic justification. The NAO workplan for 2006 includes an audit which analyses in-depth the reasonableness of renting buildings and which will provide a framework for future assessment of the justification of decisions. In the future, the same framework could help the

contracting authorities to avoid misuse or decisions that seem like misuse. The verifiability of decisions and the control mechanisms could provide the public with the desired assurance.

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 31.12.2005 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

31.05.2006

6. Auditor's report

AUDITOR'S REPORT

To the Parliament:

We have audited the National Audit Office's (hereinafter „Office“) annual accounts concerning the financial year that ended on 31 December 2005. The Office's management is responsible for the accuracy of these accounts. We are responsible for the opinion we express on the annual accounts on the basis of our audit. The Office's financial statements as at 31 December 2004 have been audited by other auditors who have issued a report without observations on these statements on 30 May 2005.

Our audit has been conducted in accordance with the Estonian Auditing Rules. Pursuant to the said Rules we plan and implement the audit to provide sufficient assurance that the annual accounts are free from material errors and false declarations. The audit includes a sample check of supporting documents underlying the figures and disclosed information given in the annual accounts. The audit also includes giving an opinion on the applicable accounting principles and the major accounting judgments made by the management and adopting a position on the overall presentation of the annual accounts. We believe that our audit provides adequate basis for giving an opinion.

We are of the opinion that in the material part the annual accounts provide a true and fair overview of the Office's financial situation as at 31 December 2005, and the performance and cash-flows during the accounting year in accordance with the Estonian Accounting Act and the guidelines of the Accounting Standards Board.

Veiko Hintsov

AS Deloitte Audit Eesti

Chartered accountant

31 May 2006