

Annual Report 2010
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This annual report consists of the management report, the annual accounts and the opinion on the accuracy of the report and the legality of transactions.

This document consists of 63 pages.

Dear Reader,

In 2010 the National Audit Office once again worked hard to ensure that the state truly benefits from its professional observations, conclusions and recommendations. Taxpayers have the right to demand a lot from us. Taxpayers want to see results that are worth the money spent on the National Audit Office.

Our resources are limited like everything else in our small state. This is why we have to focus on important things and avoid spreading our attention too thin. Getting bogged down in details will not let us focus on major issues which are of primary importance in the state's life and on which hundreds of millions or perhaps even billions are spent.

Auditing has traditionally been focused on the past in the entire world, but the world of auditing has changed and keeps on changing. In recent years the supreme audit institutions of the world have refocused on the future, because not much can be done with hindsight in light of the speed at which things move today.

This new direction means that the past and the present are looked at in order to provide political decision-makers – the parliament and the government – with information about the future at the right time.

The National Audit Office must be firm, but act on the principle that a critical evaluation given by someone must always be accompanied by a positive programme or a suggestion of how things could be done better. We are not out to draw blood or send someone to prison, but as an audit organisation based on international standards and practices, we make recommendations on how to improve the functioning of systems.

One of the duties of a modern European supreme audit institution is to say whether or not the government is telling the truth to the parliament in its reports on the use of budget funds, and another is to give the parliament information about how the government is implementing policies and what the government is achieving with taxpayers' money. Thus, the function of the National Audit Office is to provide decision-makers with a panoramic view: an impartial outsider's take that does not pretend to be the one and only truth.

Reports of the National Audit Office have to tell people in their own language, and not in the language of officials, what the state is doing with their money and whether or not people are getting what has been promised to them for their money. The National Audit Office of Estonia is therefore obliged to give information at the right time, as this helps to make decisions and create policies whose results will only be seen several years down the line. The role of our audits is to raise awareness of issues and encourage an exchange of ideas about how to resolve or prevent problems as rationally as possible.



Mihkel Oviir
Auditor General

April 2011

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1. MAIN ACTIVITIES OF THE NATIONAL AUDIT OFFICE IN 2010

Who does the National Audit Office work for?

The National Audit Office (hereinafter also referred to as the NAO) is an independent auditor that acts in the interests of and is hired by the taxpayer, whose task is to investigate how state and local authorities have spent the taxpayer's money and what they have given them for it. The results of the NAO's work are aimed, above all, at the Riigikogu, the government and the public.

Whilst the NAO and ministers are discussion partners whose duty is to work in the interests of ensuring that the state takes care of taxpayers' affairs as well and as economically as possible, the Riigikogu is both the guide and the mediator of the discussion. On one hand, it provides a framework for discussions with laws and on the other hand, it uses the information obtained by the NAO to evaluate how the government has considered the will of the representatives of the people i.e. adhered to laws when spending the state's money. The NAO is not interested in the formal compliance of activities with laws alone, but takes an equal interest in whether or not our laws and the government's actions are sufficient to ensure purposeful and expedient use of funds and the kind of reporting which gives an adequate view of spending. This means that the purpose of communication with the Riigikogu is to make proposals for improvement of public governance (i.e. above all, the use of taxpayers' money). The NAO is not authorised to punish anyone or exercise authority on its own, but merely to help decision-makers by making recommendations.

On the basis of the audits carried out over the year the NAO prepares an annual summary report to the Riigikogu on the use and preservation of state assets in the previous budgetary year. This is a constitutional obligation of the NAO.

The main role of the taxpayer in this is obviously that of the owner: without the taxpayer, there would be no money to spend and it would be impossible to audit how it is spent, or to criticise either spending or auditing. Regardless of the subject matter, the main issue is always the taxpayer's or the owner's money, which is why the audit results of the NAO reach the public through our website and the media.

Both the Constitution and the National Audit Office Act declare that the NAO is an independent institution that decides on whether and when to conduct an audit and what its focus should be. However, the NAO is not interested in the kind of independence where nothing depends on it. We are prepared to consider the requests of those we work for within the scope of the criteria we have set for ourselves (to conduct audits whose results can be generalised with regard to general government in a broader sense; the highest possible number of citizens seriously affected by the subject; the amount of money). The subjects of audits are mainly identified as a result of monitoring. This means gathering systematic information about the areas of life that interest the NAO in order to obtain an overview of the problems and the actions of the state in resolving them. In addition to searching for new audit subjects, we observe the state of affairs in areas that have already been audited, monitoring the fulfilment of the recommendations made in the audit or making plans for follow-up audits.

The phrase used for institutions like the NAO in international jargon is 'supreme audit institution', which means that in addition to its main activity, which is auditing, it also has a say in other control activities in the public sector. The NAO's auditors advise officials on the development of management, accounting and internal control systems, and internal audits. The main goal is, of course, to control as much of the taxpayers' money as possible at the lowest possible cost.

The nature of financial audits

The State Budget Act stipulates that the NAO's duty is to assess the annual report prepared by the Government of the Republic. All audit departments have to express an opinion on this report, and in order to fulfil this function, financial audits are planned and carried out in such a manner that the state's

primary cash flow, assets and liabilities are all audited. Based on risk assessments this may mean financial audits in ministries and their agencies as well as in state foundations, state-owned companies, etc.

The NAO carries out its audits according to the INTOSAI (International Organisation of Supreme Audit Institutions) auditing standards, which stipulate that a financial audit consists of the following:

- an audit of annual accounts, which contains an opinion on the financial statements; and
- an audit of legality, which focuses on the lawfulness of transactions, i.e. assesses the adherence to applicable legislation (performance of compliance requirements).

When we audit Annual accounts, we want to assure the reader that the annual accounts correctly recognise the activities of the reporting entity during the period and its financial situation at the end of the period. When we audit the legality of transactions, we assess whether or not the audited entity has, in its economic activities, adhered to the most significant legislation applicable to its operations.

Without making any assessments, we also point out the observations made about the financial management and internal control systems in the course of the audit.

The nature of performance audits

The objective of a performance audit is to give the Riigikogu, the government and the public information about how well the state has achieved the goals it has set for itself. Mostly, this means informing the public about any deficiencies in the state's activities and guiding the officials in charge to attend to these problems. However, the NAO does not merely point out the deficiencies and describe them, but it also tries to analyse the reasons behind the problems and suggest ways of resolving them. Another goal of performance audits is to identify the best administrative practice and to contribute to its promotion.

Problems in daily life and the public sector's actions in resolving them are the objects of performance audits and the monitoring activities on which these audits are based. The NAO tries to focus on problems which influence many people over a long period of time and where the existence of systematic omissions in the state's activities can be assumed. Avoiding any interference with party politics, the NAO also considers whether or not the government has done or planned to do anything to resolve the problem in question when it selects subjects for its performance audits. However, the NAO may also audit a problem for which the government does not have a specific action plan, but which is important for the achievement of a national goal determined at a more general level.

A performance audit focuses on three aspects: economy, efficiency and effectiveness.

Economy (minimisation of expenses incurred for the achievement of goals) is usually not separately audited by the NAO, but assessments of the economy may be made when efficiency is investigated.

When the NAO assesses **efficiency**, it analyses the processes administered by the public sector – how the results of activities can be improved with the same resources or achieved at a lower cost and whether this is possible at all.

The NAO analyses the following when assessing **effectiveness**:

- the achievement of the goals declared in legislation and planning documents; and
- the actual impact of an activity compared to the intended impact (if information about the impact is unavailable or inadequate, the NAO attempts to gather information on its own).

The NAO is also interested in the prerequisites of efficiency and effectiveness. This means analysing whether or not the public sector takes account of the principle of sound administration and the needs of

society when planning and implementing its activities. The NAO may also investigate whether or not the government is pursuing any purposeful activity for the achievement of a certain social goal, how this activity is developed, whether and how it complies with the government’s other activities, and whether or not it is adequately managed. Considerable attention is paid to the availability and reliability of reporting information that characterises expenses, results and impact.

1.1. Structure

The structure of the NAO in 2010 was the following:

- Financial Audit Department (Director of Audit Ines Metsalu);
- Performance Audit Department (Director of Audit Tarmo Olgo); and
- Local Governments Audit Department (Director of Audit Airi Mikli).

The work of the Auditor General and the Audit Departments was supported by the Administrative Service; Information and Communication Technology Service; Methodology, Planning and Analysis Service; Human Resources Service; Accounting Service; International Relations Service; and Legal Advisor. The general manager of these services is Director of Corporate Affairs Tõnis Saar.

The Secretariat of the INTOSAI Working Group on Environmental Auditing also operates under the NAO and is managed by Director of Corporate Affairs Tõnis Saar.



1.2. Financial Audit Department

The task of the Financial Audit Department is to express an opinion of the correctness of the state's consolidated annual report and the legality of its transactions. This obligation was placed on the NAO with the State Budget Act. Another task of the Financial Audit Department is to express an opinion on the annual accounts and the legality of the transactions of constitutional institutions.

In order to give an opinion of the consolidated annual report of the state, the Financial Audit Department audits the accounting and transactions of all ministries every year. When the NAO audits ministries, it cooperates with the internal audit entities of the ministries whenever possible, as pursuant to the State Budget Act such entities are obliged to audit the annual accounts and the legality of the transactions of ministries. The state's annual accounts are consolidated with the annual accounts of foundations established by the state, companies in which the state is a shareholder and profit-making state agencies. The NAO does not audit these entities, but relies on the work of certified auditors when expressing its opinions.

When giving an opinion of the accuracy of the annual accounts of the ministries and state, the National Audit Office assesses the compliance of the annual accounts with the Generally Accepted Accounting Principles of Estonia, the Accounting Act and relevant regulations of the Minister of Finance.

When assessing the legality of transactions, the NAO checks whether or not the transactions were concluded in accordance with the State Budget Base Act and the Annual State Budget Act. The NAO also checks whether or not the requirements stipulated in the Public Procurement Act and the State Assets Act were adhered to in the case of important transactions.

The procedure for auditing the public sector changed in 2011 and the NAO also has to assess the accuracy of the annual accounts of every ministry as well as the legality of their transactions. This means that NAO will be obliged to give its opinion not only at the level of state, but also at the level of accounting entities, i.e. ministries. Although it increases the workload of the NAO, the state as a whole will be able to save resources, as the current irrational and overlapping organisation of work between the NAO and the internal auditors will end.

The goal set for the department when it was established in November 2008 was to develop, within the subsequent three years and in the course of auditing the state's consolidated annual reports, the capacity to perform the duties of a so-called group auditor in giving an opinion of the state's consolidated annual report for 2011. On one hand, this obligation arises from the state's consolidated reporting system applied in Estonia and on the other hand from the INTOSAI Standards and the National Audit Office Act, the State Budget Act and the Authorised Public Accountants Act. Acting as a group auditor entails guiding the activities of all auditors operating in the public sector and it should improve the quality of public sector audits, because audits are carried out on the same basis, under the same management and in a streamlined manner.

The activities required for the achievement of the established goal continued alongside the audits in the past year. The department submitted its proposals for the specification of legislation (incl. the National Audit Act and the State Budget Act) to the Ministry of Finance in order to guarantee clear objectives of financial audits and the NAO's position as a group auditor. A training plan was developed for financial auditors to help them prepare for the professional examination and a twenty-day training cycle was passed from 2009 to 2010. The methods used in financial audits were reviewed and updated in light of the new financial audit implementation guidelines of the INTOSAI. The NAO also ordered an external opinion of the quality of its financial orders for the second consecutive year in order to learn from the experience of certified auditors in the private sector.

Monitoring the development of state accountancy and contributing thereto by making recommendations is an important activity of the Financial Audit Department. The organisation of accounting is under separate scrutiny in audits, because the Government of the Republic is planning to implement a common

information system for financial, personnel and payroll accounting in all state agencies, and to introduce e-bills, other e-documents and a web-based reporting system.

Another area that was scrutinised by the Financial Audit Department was implementation of the new Authorised Public Accountants Act and the ensuing changes in the auditing of public sector entities and the organisation of work in internal audit departments of the public sector. The Authorised Public Accountants Act that entered into force in 2010 also applies to the financial audits carried out by the NAO. Certified auditors who have passed professional examinations of auditors in the special part of public law are the only auditors who have the right to audit public sector entities from 2011.

We had 20 positions in the Financial Audit Department at the end of 2010: 1 director of audit, 3 audit managers, 7 senior auditors and 9 auditors. Four new positions were created during the year to perform the extra duties assigned to the department from 2011. There were no vacancies in 2010.

Most significant audit results

The Financial Audit Department organised 18 audits in the year, all of which ended with the publication of audit reports. The NAO used the observations and conclusions made in the course of the audit of the state's consolidated annual report in its overview of the use and preservation of state assets.

Report of the National Audit Office on the state's consolidated annual report for 2009

The opinion of the NAO is that the state's annual report for 2009 is true in all material respects and economic transactions have been carried out in accordance with the State Budget Act in all material respects. The centralisation of support services should increase its focus on the development of further IT solutions as well as the provision of day-to-day IT help, and on the implementation of an electronic document management system. IT development is extremely important in order to ensure that the centralisation has the intended effect. It is necessary to avoid unnecessary rushing at the expense of thorough preparations, i.e. the transition should not be permitted or forced unless everyone is ready for this both organisationally and in terms of IT solutions. The NAO also advised to monitor that the ability of the staff to understand the content of the transaction is considered in planning the composition and workload of the people who will be working in the accounting centres and to demand that ministries provide detailed descriptions of the structure of their internal control systems when accounting is centralised.

The audited economic transactions of 2009 were generally carried out in compliance with the State Budget Acts. The NAO only made a comment about the renovation of St John's Church in St Petersburg to the Ministry of Culture. The State Concert Institute EESTI KONTSEERT, which operates in the area of government of the Ministry of Culture, breached the State Budget Act when it renovated this church by taking a loan and exceeding the limit stipulated in the Act when entering into the contract (the cost of the contract exceeded the investment budget prescribed for the year by 50%) on the account of future budget years.

When the NAO audited the legality of transactions, it found that ministries had still not planned their budget revenue and expenditure (incl. investments) accurately. Similarly to previous years, investments were used to cover household expenses and vice versa, and obligations that are prohibited by the State Budget Act were sometimes taken. The NAO noted about the State Budget Execution Report that its manner of presentation does not allow the reader to compare the state budget accepted as a legal act with its actual execution.

In conclusion, however, it can be said that accounting in state accounting entities, i.e. ministries and constitutional institutions has improved year by year. This has allowed the Ministry of Finance to prepare an increasingly more accurate and thorough financial report about the state as a whole.

Ines Metsalu
Director of Audit, Financial Audit Department

1.3. Performance Audit Department

The Performance Audit Department assesses the efficiency, effectiveness and economy of the state's activities in all ministries, in the state agencies operating in their area of government, in legal entities in public law and in foundations where the rights of a founder or a member are exercised by ministries. The Performance Audit Department also audits state-owned companies where the ministers who manage ministries must represent the state's interests in carrying out the majority interests that belong to the state in these companies.

Since 2009 the Performance Audit Department has focussed on assessing the state's performance in the following areas: the natural environment, the economic environment, the area of social affairs and health, and the state's infrastructure.

In the course of the audits, the department drew the attention of the decision-makers to the following:

- the good state of public finance may be an illusion and fragile, unless we focus on increasing the competitiveness of our economy and sustainable development of various sectors;
- important reforms that require the decisions of the government and the Riigikogu have still not been implemented; and
- we must look further ahead when we make decisions and take more notice of the impact of things already done.

There were 31 positions in the department, incl. 1 directors of audit, 5 audit managers, 10 senior auditors and 15 auditors. There were no vacancies at the start of 2010. The department hired 4 auditors and 1 senior auditor in the year. 1 senior auditor left the department in the year. The department had 35 filled positions by the end of the year.

The main objectives of the department were to give the Riigikogu and the public an overview of the sustainability of state forest management and the state's activities in recovering packaging waste in the area of environment, the success of in-service training and re-training of adults in the area of education, the effectiveness of enterprise support in the area of the economy, the sustainability of the hospital network in the area of healthcare and to assess the effectiveness of the state's activities in supporting disabled persons in the area of social affairs. Attention was also paid to the problems of financing the area of culture in 2010.

The strategic internal goal of the department was to improve the professional competence of auditors and to guarantee that NAO staff have the high level of skills and knowledge required to audit the public sector. In order to improve their audit skills, performance auditors took part in the 11 modules of a long-term training programme, which covered subjects from the areas of public administration, law and economy as well as audit methodology. Teachers from academic institutions, practitioners and the NAO's own employees take part in carrying out the training programme.

In 2010 the department completed 14 performance audits, prepared an expert opinion on the initial public offering (IPO) of the shares of Eesti Energia and gave an overview of the use and preservation of state assets to the Riigikogu. The department also carried out thorough audit operations in the Climate and Energy Agency in order to respond to the queries submitted by members of the Riigikogu.

At the international level, environment auditors helped introduce international guidelines for auditing the areas of forestry, mining, fishery, climate change and sustainable energy in cooperation with the WGEA Secretariat managed by the NAO. Completed environmental audits were showcased at various international seminars, and our team was involved in training the employees of other supreme audit institutions as teachers.

Most significant audit results

Sustainability of the hospital network

In the course of the audit the National Audit Office found that the active treatment hospital network set out in the hospital network development plan is too big and unsustainable, because not all hospitals will have enough patients, qualified doctors or money for improvement of the hospitals in the future.

The population of Estonia has decreased constantly after Estonia regained its independence, and this decrease has been the biggest (7.9%) in regions with smaller hospitals. The service areas of hospitals planned during the establishment of the hospital network were bigger than they actually are by now. Also, the trends of recent years have shown that increasingly more patients from rural areas seek treatment from the regional or central hospitals in cities rather than the hospitals in their own counties. Rural hospitals receive less money due to the decrease in the number of patients, which means that they are unable to hire qualified staff and develop quality methods of treatment.

However, a hospital cannot function without qualified staff. It became evident in the course of the audit that 16% of doctors working in hospitals have attained retirement age and the share of retirement-age doctors in county hospitals is more than a quarter. The situation will become particularly complicated within ten years, because the number of new doctors is not sufficient considering the size of the age groups that are about to attain retirement age. The situation is especially difficult in county hospitals where the share of retirement-age doctors is the biggest, but which have managed to hire only a couple of young full-time doctors.

Hospitals estimate that 8.5 billion kroons should be invested into the modernisation of active treatment hospitals. Although the state has supported the modernisation of some hospitals with EU funds, it does not cover the investment needs of all hospitals. Hospitals themselves cannot make the necessary investments using only the funds earned for the provision of treatment services. The state should therefore assess and decide whether it can afford such a large hospital network and find money for investments.

Considering the above, the NAO found that the development plan of the Estonian hospital network and the current hospital network exceed Estonia's needs and, above all, what the state can afford. The Ministry of Social Affairs has failed to seize the opportunity to guide the development of the hospital network. To the contrary, the ministers' decisions about the list of general hospitals and establishment of requirements for hospital types made so far have led to the situation where the current hospital network is even larger than stipulated in the hospital network development plan.

On the basis of the audit the NAO advised the Minister of Social Affairs to prepare a new hospital network development plan in 2010, which would be a compromise between regional provision of specialised medical care and the available resources.

The state's activities in supporting disabled persons and persons receiving pension for incapacity for work

The audit results indicated that the current system for supporting disabled persons and persons receiving pension for incapacity for work does not function reasonably – it does not guarantee comprehensive assistance that reaches those who actually need it. The state, however, spends more than three billion kroons per year on disability benefits and pensions for incapacity for work.

The main drawbacks of the system for supporting disabled persons are the state's inability to assess the additional expenses arising from disabilities from all angles, which means that actual assistance in the form of medicines and technical aids remains unavailable for some when support is paid. Support is not paid for expenses already incurred but as cover for additional expenses disabled persons are anticipated to incur, which means that people may use the money for other purposes than those intended by the

state. For example, people may spend the money on other necessities instead of medicines or technical aids.

As disabled persons do spend more on medicines and technical aids, the National Audit Office advised the Minister of Social Affairs to change the system of compensating for medicines and technical aids in such a manner that the state would enable disabled persons to buy the medicines and technical aids they need at lower prices. The National Audit Office also advised the Minister of Social Affairs to analyse the system for supporting other age groups (children and old-age pensioners) and compensating other additional expenses, and to consider terminating payment of monthly support for anticipated additional expenses to disabled persons.

In the opinion of the National Audit Office the biggest drawback in the system for supporting persons receiving pension for incapacity for work is that the system does not motivate people who have lost the capacity for work to return to the labour market, as they are not offered any rehabilitating labour and health services, and the state assesses a person's incapacity for work rather than their capacity to do different work or learn a new trade. The state also pays the pension for incapacity for work to persons whose income is not small and who can successfully support themselves with work.

The audit indicated that 60% of all persons receiving pension for incapacity for work did not earn any other income at the same time – they are basically supported by the state. Only 35% of all persons receiving pension for incapacity for work who had lost part of their capacity for work (40-90%) were earning wages. However, 5% of people who had fully lost their capacity for work had also earned income.

The National Audit Office advised the Minister of Social Affairs to change the system for assessment of permanent incapacity for work in such a manner that the person's capacity for work rather than the loss thereof is assessed first and foremost. Without abandoning the principle that as many persons receiving pension for incapacity for work as possible could be working, the National Audit Office believes that payment of the pension for incapacity for work should be tied to the income earned by the person at the same time. This requires the establishment of the maximum income a person can earn without losing the right to receive pension for incapacity for work. The state should also create a work-related rehabilitation programme, which would give people the opportunity to retrain and create the preconditions for their return to the labour market.

In-service training and retraining of adults

The National Audit Office found in its latest audit that the organisation of in-service training and re-training of adults is not systematic and does not support employees in gaining or updating their qualifications. Although the state is spending almost two billion kroons on adult training between 2008 and 2013, it has not managed to reach a consensus on the kind of qualified workforce that is needed in the changing economic environment. The state also lacks an overview of the training that has taken place, the money that has been spent and the results that have been achieved, all of which are needed for the planning of further training and assessment of results.

The audit indicated that the organisation of the in-service training and re-training of adults is highly fragmented – at least 16 different agencies and 25 measures co-funded by the European Union are involved in the financing and organisation of such training. Adult training is coordinated by the Ministry of Education and Research, although in practice the activities of a number of agencies have been sidelined in coordination mechanisms. For example, the Development Plan for Estonian Adult Education 2009-2013 does not incorporate activities in the areas of government of the Ministry of Agriculture, the Ministry of the Interior, the Ministry of the Environment or the Government Office, even though a total of approximately 800 million kroons in funding is planned to be allocated to them for the organisation of in-service training and re-training for adults (i.e. almost 40% of all funding planned for adult training).

Due to the lack of centralised management, agencies are identifying training needs and planning and assessing training separately, rendering the system inefficient and often leading to overlaps.

As a result of its audit, the NAO recommended that coordination in the field be improved. Better coordination and the development of quality assurance would also help to ensure that funds are used more economically and efficiently. Taking into account the national objectives of improved competitive ability and economic growth, more funding should be channelled into training, which will see participants gain new or update their existing qualifications and into re-training.

Impact of state's enterprise support on the competitiveness of the Estonian economy

The NAO pointed out in the audit although the state distributed more than seven billion kroons as enterprise support from 2004-2009, it has not helped make Estonia's economy more competitive – the low productivity and export capacity of companies, which are the basis of an economy's competitive advantages, have not improved much as a result of the state's support.

The reason why enterprise support is so ineffective is the inflexible and fragmented support system that has no focus. It tries to approach a myriad of problems at the same time and often fails to take account of the actual needs of companies. The state spreads the support money across various economic sectors, but only a few companies actually benefit from the support and its impact on economy and economic sectors is almost non-existent.

The results of the audit confirm the earlier opinions of economic experts that the state's enterprise support system has benefited only a few separate companies (whose integration with Estonia's economy is weak), and there has been no noticeable improvement in economic indicators or cooperation between companies.

The state's lack of interest in evaluating the impact of its enterprise policy has contributed to the limited impact of enterprise support. The Ministry of Economic Affairs and Communications has no idea whether or not the support, guarantees and loans granted via Enterprise Estonia and the Credit and Export Guarantee Foundation have had any impact on business or what that impact might be. The situation is compounded by the fact that policies are based on European Union funds (90% of the enterprise support in 2010 is money from the European Union), which for many years have focussed on the distribution of money and reporting on effective percentages of use rather than trying to ascertain whether or not the distributed funds have created any permanent benefits.

The NAO advised the Ministry of Economic Affairs and Communications to review the existing enterprise policy in order to increase the impact of enterprise support. Instead of merely distributing the money received from the European Union, the state should integrate the various and currently separate business promotion measures – education, research and development, taxation, business regulation and support – in order to increase the competitive strength of Estonia's economy. The NAO believes that in addition to strengthening its overall financial position, the state also has to pay attention to redesigning the structure of Estonia's economy and improving its competitive strength so that the next period of recession does not result in employment as high as the current one. In the long run, the welfare of every person living in Estonia depends on the success of the state's business policy.

Sustainability of state forest management

The NAO found in its audit that the State Forest Management Centre is carrying out felling on prime state forests – old trees on fertile soils – at a rate faster than such forest can regenerate, i.e. reach a similar age of felling maturity. This reduces the chance of future generations being able to manage state forests as profitably as is currently being done, since the best trees at the right age for felling will, at some point, simply run out.

The NAO found that, taking into account the division of state forests by species and age, the extent of annual clear cutting in mesotrophic, mesoeutrophic and nemoral forests must be considerably reduced:

compared to the volumes planned for 2010, by ca. 30% in majority pine forests; by 40–50% in majority spruce forests; by ca. 50% in majority birch forests; and by ca. 70% in majority aspen forests.

The audit also pointed out that it would be impossible to sustain the forest ecosystem, which is currently in good condition, if the present rate of felling continues. The decrease in the area of old forests and the felling of younger and younger forests reduces the natural value of forests as a whole, since older forests display greater biodiversity and form habitats for a larger number of different species, included endangered and protected ones.

The NAO advised the Ministry of the Environment to amend the legislation that regulates forest management in such a manner that it would require consideration of different forest types and the spatial location of the forests to be felled when felling is planned. The amended forest management regulations must ensure that the area of old forests does not decrease by forest type and that the network of protected areas does not become less cohesive as a result of management.

Effectiveness of collection and recovery of packaging waste

The results of the audit indicated that packaging companies do not collect or recover the packaging they bring to the market to the required extent. The main reasons for this are the inadequate supervision exercised by the state over packaging companies, the recovery organisations that represent them and the recoverers of packaging waste, and the limited awareness of residents of the need to collect packaging waste.

Estonia failed to meet the target rates of packaging recovery set by the European Union in 2009 due to inadequate supervision. According to the calculations of the NAO the state could have collected approximately one billion kroons in packaging excise from the companies in 2009, because the quantity of collected and recovered packaging waste was smaller than it should have been. However, this money is lost to the State Treasury, because state supervision has not been able to identify the offenders and it is not known which of the companies have failed to perform their obligations.

The audit pointed out that the Environmental Inspectorate, the Tax and Customs Board or the Environmental Information Centre that keeps the Packaging Register have been unable to guarantee that packaging companies and recovery organisations give information about the actual quantity of packaging brought to the Estonian market and how much of it is recovered. The analysis carried out by the NAO indicated that supervisory agencies have not checked the data submitted by the packaging companies belonging to recovery organisations (an estimated 80-90% of all packaging companies) at all.

The NAO advised to demand the payment of packaging excise duty immediately after the packaging is brought to the market in order to ensure that the packaging excise duty achieves its goal, which is to force companies to collect and recover the required quantity of packaging. However, this means that the inspection of packaging companies and the data they submit must be more efficient.

The audit also highlighted that one of the reasons why not enough packaging is recovered is the limited awareness of people, and disposing of packaging waste is often inconvenient for people. The audit carried out by the NAO indicated that 54% people living in Estonia do not know that they can dispose of packaging waste free of charge. Sorting waste would considerably reduce waste removal charges, because packaging waste comprises almost a half of the volume of waste bins.

Grants of the Ministry of Culture, the Cultural Endowment and the Gambling Tax Council to concert and performance activities

The NAO found that the system for distribution of operating and project grants in the area of music and theatre via the Ministry of Culture, the Cultural Endowment of Estonia and the Gambling Tax Council is inefficient, because the objectives, target groups, supported activities and also the decision-makers overlap to a large extent.

The audit highlighted that the Ministry of Culture has not adhered to the Performing Arts Institutions Act when allocating grants to theatres and concert organisations. Content and procedural requirements were both ignored in financing concert activities and the system developed for financing theatres did not comply with the basis given in the Act.

Also, programmes of the Ministry of Culture and the grants of the Cultural Endowment of Estonia and, to a lesser extent, the Gambling Tax Act have partially been used for the provision of additional financing to state performing arts institutions, which is why the state has no overview of how much the maintenance of performing arts institutions that are financed from the state budget actually costs.

As the roles of the grants given by the Ministry of Culture, the Cultural Endowment of Estonia and the Gambling Tax Council are almost indistinguishable and control systems are unable to always guarantee that the money is used lawfully and expediently, the NAO finds that maintaining three separate systems for supporting concert and performing activities is not justified.

Results of the development of the state's information systems

The audit of the efficacy of the development processes of state information systems revealed that it often remains unclear what benefit an information system is meant to provide to the state. The majority of development projects are instigated without evaluating their technical and financial feasibility and necessity. Moreover, in many cases some of the required parties fail to be included in the development projects, as a result of which the information systems which are created do not always meet the expectations of users.

The audit also pointed out that the duration and budgets of developments are not being planned with sufficient accuracy and that project-based cost accounts are not being kept. The upkeep costs of the systems created are not being assessed, and there are generally no criteria for the assessment of the success of projects.

Omissions in the development of information systems result in missed development project deadlines, increased costs and dissatisfaction among the owners and users of the information systems.

In order to boost the efficacy of the development of state information systems, the NAO has recommended that clear requirements be established by the Ministry of Economic Affairs and Communications for the instigation, implementation and reporting on development projects related to state information systems and that a common electronic environment for the management of projects be created.

Availability of public services in counties

The audit revealed that insufficient attention is being paid to the availability of public services in Estonian counties and that there is no comprehensive plan for the formation of a network of public departments.

Public services are not uniformly available, because there is no comprehensive vision of the location of state agencies, management of the development of the nationwide service network is fragmented and decisions about services that are important for people are made on the basis of how much money is available.

The NAO advises the government and ministers to take the essential steps that would guarantee the availability of important public services at least in county centres and improve the process of reorganising state agencies. Any reorganisation should be based on the needs of people and be well thought through, and the associated expenditure must be in balance with the expected benefits.

Tarmo Olgo
Director of Audit, Performance Audit Department

1.4. Local Governments Audit Department

The Local Governments Audit Department audits the lawfulness of the internal control systems, financial management, financial accounting and economic activities of local authorities and the foundations and non-profit organisations founded by local authorities in which a local government is a member, and in companies where a local government has a dominant influence, as well as the reliability of their information technology systems and the lawfulness and effectiveness of the use of the state assets granted to local authorities and of the ad-hoc aid allocated from the state budget and funds allocated from the state budget for performance of state functions.

13 positions were planned and filled in the Local Governments Audit Department at the beginning of 2010: 3 audit managers, 4 senior auditors, 5 auditors (the service relationship of 1 audit manager and 1 auditor has been suspended) and a director of audit. The department has carried out audits with two teams instead of the earlier three, as the service relationship of an audit manager was suspended in 2010. The department had to make changes in the organisation of its work and the composition of its team in order to cope with the planned work. There were no vacancies in the department at the end of 2010.

In brief, the goals set to the department for 2010 were as follows:

- to highlight the problems and risks that prevent the sustainable, efficient and honest functioning of local authorities;
- making proposals for improvement of the legal environment at the state and local levels in order to improve the administrative capacity of local governments, create pre-conditions for strengthening local governments and improving the quality of public services; and
- increasing public control for the purpose of preventing the threat of corruption and other violations with impartial conclusions, opinions and recommendations.

The audits carried out in 2010 focussed on the foundations and non-profit organisations established by local authorities and on the companies controlled by local authorities. Attention was also paid to the coping problems of local authorities that resulted from the quick changes in their financial situation.

Another goal in 2010 was to improve the professional knowledge of our auditors. The auditors took part in a diverse training programme and some of them also improved their skills and knowledge of conducting financial audits. The extensive training programme will continue also in 2011, which is why the organisation of audits takes a little longer than usual. However, the increasingly better knowledge of our auditors makes it possible to carry out better audits.

Six of the 15 so-called field audits or overviews, which cover local authorities and were initiated in 2009, were completed in 2010. Our auditors also participated in the audit “Quality of Public Services in Information Society”, which was carried out by the Performance Audit Department, and checked the financial data of local authorities in order to give an opinion on the consolidated annual report of the state. In addition to the audit operations, the department prepared a part of the overview of the use and preservation of state assets which was submitted to the Riigikogu by the Auditor General. The department also helped prepare the Auditor General's opinions on various draft acts.

In 2010 the department focussed its attention on harmonising the organisation and methodology of audits. Special attention was given to the implementation of the Compliance Audit Guidelines (ISSAI 4100).

Since a clear division of duties and funding between different levels of authority in the coming years is extremely important for the development of the organisation of local authorities, the Local Governments Audit Department spent most of its time on monitoring the course of the process. The next tasks are to describe the public services of local authorities and to determine their minimum levels.

The department has constantly attended meetings with local government leaders and county and national local government associations, and introduced the work of the department as well as the results of the completed audits. A good example of these is the local government and regional development roundtable organised by the President of the Republic of Estonia, where the department introduced the audit “Prevention of Corruption in the Organisation of Work of Municipalities, Towns and Cities”. Other activities that deserve a mention include the training day organised by the department in the Police Board for teams that investigate crimes of corruption and the training for certificated auditors, who audit or would like to audit local authorities, which was organised in cooperation with the Board of Auditors. The ruling made by the Supreme Court meant that streamlining the relationship of the state and local authorities became a priority in 2010 and the department also contributed to the respective discussion “How to Make the Organisation of Local Government Funding Comply with the Constitution?” held between the Auditor General, the Committee of the Riigikogu, the Chancellor of Justice and others. The same subject has also been discussed in the Ministry of Finance.

The audit that received the most attention in 2010 was “Prevention of Corruption in the Organisation of Work of Municipalities, Towns and Cities”, which was introduced in many counties. Representatives of the department have been invited to discuss the subject at several roundtables, such as the discussions organised by Transparency International Estonia.

The problems of local authorities have received more attention from the state and the public with the help of the audits carried out by the department. The problems highlighted and the recommendations made in audit reports are considered in the development of legislation concerning local authorities, as the audits conducted by the NAO are referred to in the explanatory notes to draft acts. The amendments to the Financial Management of Local Authorities Act and to the Public Procurement Act, which were adopted in 2010, could be separately highlighted. This confirms that audits of municipalities, towns and cities have pointed out the actual problems and weaknesses of local authorities and the reasons behind them.

Most significant audit results

Granting cultural, sports and youth work grants to citizens’ associations from municipality, town and city budgets

As a result of the audit, the NAO ascertained that all audited local authorities had paid grants for cultural and sports activities and youth work. The payment of support cannot be considered transparent because many local authorities have no rules for such a procedure, and in those that do cases of ‘special treatment’ were frequently found. Once a grant had been allocated, the audited municipalities, towns and cities showed no interest in what the money was used for, or only did so formally.

Analysis of the changes that took place in 2009 in the expenditure and revenue and financial statuses of municipalities, towns and cities

The NAO analysed the changes that took place in 2009 in the expenditure, revenue and financial statuses of local authorities. The NAO is of the opinion that many local authorities have been too slow in reacting to the changes in the economic environment. There were delays in accepting the need to reduce costs and in implementing relevant measures, as a result of which there was significant spending of reserve funds amassed in previous years. With revenue continuing to decrease, this has placed local governments in a difficult position in 2010.

Organisation of public procurements by companies, foundations and non-profit organisations established or partially owned by municipalities, towns and cities

The NAO found that a significant part of public purchases are still made without public procurements. A number of companies and their local government owners do not understand that operating in a manner that is transparent and promotes competition helps reduce both waste and the threat of

corruption in companies. At the same time, the state has not done everything in the area of public procurement to guarantee a clear and unambiguous legal framework and instruction as well as state supervision that proceeds from the actual activities of companies.

Participation of municipalities, towns and cities in companies and foundations

There are quite a few companies and foundations that operate under the control of local authorities: ca. 380 in April 2010. It is considerably higher than the number of local authorities. As these companies usually offer services that are important for the local community, the interest of local residents calls for a sustainable management of such companies. Moreover, cases where the activities of a company are financed largely from the municipality, town or city budget, i.e. where tax revenue is used for the management of the company are not rare. According to the NAO, local authorities have not always established observable goals for their participation in the audited companies and foundations. However, there were serious omissions in the organisation of management in the audited companies and the NAO finds that public interests are not well protected in the companies where local authorities have holdings.

Organisation of local road maintenance

Many local authorities have not been following the law in the organisation of road maintenance for a long time, but the state as the entity that established the requirements has done nothing to improve the situation. One of the consequences of the failure to meet the requirements in the opinion of the National Audit Office is that it is impossible to ascertain whether or not a local government has taken sufficient measures to guarantee safe traffic on local roads.

The audit also revealed that amount of financing required for local road maintenance has not been ascertained in Estonia. This is why politicians cannot agree on how much tax revenue should be allocated to local road maintenance, and their opinions are not based on actual needs.

Overview of the land of municipalities, towns and cities

The overview once again highlights the problem that rapid completion of the land reform is looking unlikely. There have been many discussions of how to start the completion, whether to create a land reserve of the state from the land not yet reformed so the land can be sold or given in the use of local authorities, or whether unreformed land should be given to local authorities first of all. As the overview focuses on the issues of municipal land more broadly than just the land reform, the National Audit Office has not considered the possible options for completing of the reform. The overview also does not answer the question of how much land local authorities should own. Local government leaders find that there is not enough land, but this cannot be confirmed, as the need of local authorities for land has not been ascertained. National databases do give a complete overview of the land ownership of private persons, but it is impossible to obtain a complete overview of the land owned by municipalities, towns and cities. Local authorities do not have to enter their land in the Land Register, as they get the title to the land after it is entered in the Land Cadastre. Only the Land Board keeps unofficial records of the municipal land entered in the Land Cadastre and the bases of its ownership by collecting the data it may need in its activities.

Airi Mikli
Director of Audit, Local Governments Audit Department

1.5. Audit reports, analyses and responses to parliament

Audits are presented according to ministries and their areas of administration. If an audit concerns the area of government of several ministries, it is presented for all of the ministries and institutions in question.

Ministry of Education and Research

10 May 2010 – Accessibility of public services in counties

16 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of Education and Research

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

1 December 2010 – Follow-up audit of specialised schools and juvenile committees

Ministry of Justice

12 February 2010 – Results of the development of the state's information systems

10 May 2010 – Accessibility of public services in counties

16 July 2010 – Accuracy of the Annual Accounts 2009 and the legality of the transactions of the Ministry of Justice

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

Ministry of Defence

12 February 2010 – Results of the development of the state's information systems

29 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of Defence

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

11 November 2010 – Opinion of the National Audit Office on the Annual Accounts 2009 of the Baltic Defence College

Ministry of the Environment

10 May 2010 – Accessibility of public services in counties

30 August 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of the Environment

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

20 September 2010 – Sustainability of state forest management

6 December 2010 – Effectiveness of collection and recovery of packaging waste

7 December 2010 – Supervision of the use of plant protection products and mineral fertilisers

Ministry of Culture

28 January 2010 – Grants of the Ministry of Culture, the Cultural Endowment of Estonia and the Gambling Tax Council to concert and performance activities

10 May 2010 – Accessibility of public services in counties

15 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of Culture

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

15 December 2010 – Distribution of investments in the Ministry of Culture

Ministry of Economic Affairs and Communications

12 February 2010 – Results of the development of the state's information systems

10 May 2010 – Accessibility of public services in counties

28 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of Economic Affairs and Communications

23 August 2010 – Impact of state's enterprise support on the competitiveness of the Estonian economy

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

29 September 2010 – Organisation of local road maintenance

2 November 2010 – Quality of public services in information society in 2010

Ministry of Agriculture

10 May 2010 – Accessibility of public services in counties

15 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of Agriculture

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

7 December 2010 – Supervision of the use of plant protection products and mineral fertilisers

Ministry of Finance

10 May 2010 – Accessibility of public services in counties

30 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of Finance

23 August 2010 – Impact of state's enterprise support on the competitiveness of the Estonian economy

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

6 December 2010 – Effectiveness of collection and recovery of packaging waste

Ministry of the Interior

12 February 2010 – Results of the development of the state's information systems

10 May 2010 – Accessibility of public services in counties

27 July 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Ministry of the Interior

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

2 November 2010 – Quality of public services in information society in 2010

16 December 2010 – Overview of the land of municipalities, towns and cities

Ministry of Social Affairs

2 February 2010 – Sustainability of the hospital network

10 May 2010 – Accessibility of public services in counties

15 July 2010 – Accuracy of the Annual Accounts 2009 and the legality of the transactions of the Ministry of Social Affairs

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

18 October 2010 - The state's activities in supporting disabled persons and persons receiving pension for incapacity for work

Ministry of Foreign Affairs

20 July 2010 – Accuracy of the Annual Accounts 2009 and the legality of the transactions of the Ministry of Foreign Affairs

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

Constitutional institutions

24 May 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Supreme Court

24 May 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Office of the Chancellor of Justice

25 May 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Chancellery of the Riigikogu

31 May 2010 – Accuracy of the Annual Accounts 2009 and legality of the transactions of the Office of the President of the Republic

19 July 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the Government Office

23 August 2010 – Impact of state's enterprise support on the competitiveness of the Estonian economy

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

Local authorities

25 February 2010 – Granting cultural, sports and youth work grants to citizens' associations from municipality, town and city budgets

20 April 2010 – Analysis of the changes that took place in 2009 in the expenditure and revenue and financial statuses of municipalities, towns and cities

21 April 2010 – Organisation of public procurements by companies, foundations and non-profit organisations established or partially owned by municipalities, towns and cities

10 May 2010 – Accessibility of public services in counties

2 July 2010 – Participation of municipalities, towns and cities in companies and foundations

31 August 2010 – Accuracy of the Annual Report 2009 and the legality of the transactions of the state

17 September 2010 – In-service training and retraining of adults

29 September 2010 – Organisation of local road maintenance

1 December 2010 – Follow-up audit of specialised schools and juvenile committees

16 December 2010 – Overview of the land of municipalities, towns and cities

Miscellaneous

20 September 2010 – Response of Auditor General Mihkel Oviir to the Riigikogu regarding the Climate and Energy Agency on 20 September 2010.

6 October 2010 – Overview of use and preservation of state assets in 2008

8 November 2010 – Response of Auditor General Mihkel Oviir to the Riigikogu regarding the election advertisement allegedly financed by the Estonian Confederation of Owners on 8 November 2010.

1.6. Staff

98 people had a service relationship with the NAO at the end of 2010 and 86 of them were working actively. The overall staff turnover was 3%. The previously reduced number of staff is now recovering and the organisation will be back to its former size (at the level of 2007) by autumn 2011 due to the additional duties of the Financial Department.

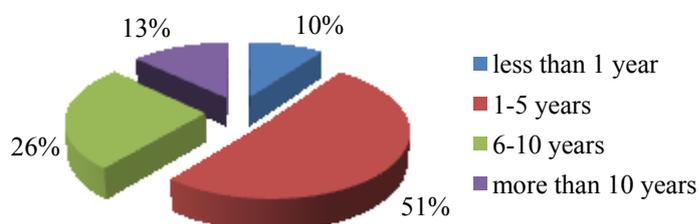
The development and training activities in 2010 supported the systematic development of the professional skills of auditors. Training focussed on the methodology in 2008 and 2009, which was supported by field training and professional training, but in 2010 the emphasis was clearly on qualification training. Carrying out the training plan that supports the acquisition of the qualification of a financial and a performance auditor continued. The grant from the European Social Fund helped instigate the development of a systematic qualification plan. A Training Council, which is still operating, was established in order to make sure that the plan is carried out as well as possible.

The NAO will cooperate with the University of Tartu and Tallinn University of Technology in order to develop its training opportunities. In the latter of the two universities, the NAO took part in the creation of the curriculum of auditing.

The total volume of internal and external training was 97 hours per employee on average.

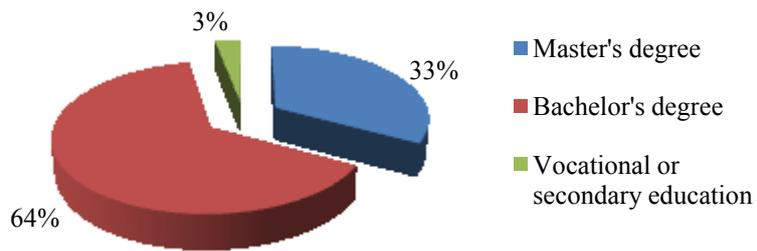
13% of the employees of the NAO have worked here for more than ten years and the share of employees who have been with us for 1-5 years remains high due to the establishment of the department that audits local authorities. The ratio of new employees who joined us in the year (10%) is 6% higher than in 2009. It is worth mentioning that the managers of our main area of activity and the managers of our services are predominantly in the group of employees who have been with the NAO for a long time.

Figure 1. Length of service of NAO staff as of 31 December 2010



A clear majority of the employees in the NAO have higher education (97%) and 33% of them have an academic degree (equalised degrees are not considered). Only 3% of employees do not have higher education. The number of employees who are continuing their education in master's or doctorate studies is also high: 11% of the employees are about to complete their studies and defend a master's degree or doctoral degree.

Figure 2. Level of education of NAO staff as of 31 December 2010



28% of the staff were male and 72% female as of the end of 2010. The share of women in the gender division of the NAO's staff has increased slightly (3%).

The average age of staff is 38 years and the largest age group is 31-40 (51%), followed by the group of employees aged 21-30 (20%).

Kairi Kübarsepp
Human Resources Manager

1.7. International communication

2010 was the year when the International Organisation of Supreme Audit Institutions (INTOSAI) organised its 20th congress. The representatives of 152 countries met in Johannesburg, South Africa, to take a look at the results of the organisation's activities in the last three years and plan the activity strategy for the next six years. The main subjects of the congress were the value of supreme audit institutions and the benefits arising from their activities, and environmental auditing and sustainable development. The congress adopted the strategic plan for 2011-2016, the International Standards of Supreme Audit Institutions (ISSAI) and the Johannesburg Accords, which sets forth the lines of action of INTOSAI regarding the promotion of transparency, reporting obligation and good governance in the work period that lies ahead.

Similarly to the last couple of years, the INTOSAI Working Group on Environmental Auditing and its management remained the priority of the NAO in foreign relations. As the head of the working group, the Auditor General submitted a report on the performance of the working group for 2008 to 2010 and introduced the work plan for 2011-2013. The Secretariat of the INTOSAI Working Group on Environmental Auditing made a significant contribution to the preparation and discussion of the second main subject of the congress. The audit guidelines and other documents prepared in the last three years were introduced. The head of the secretariat introduced the views of the working group and later took part in the preparation of the conclusions and recommendations of the congress.

In general, participation in the INTOSAI Capacity Building Committee and in the Working Group on Privatisation, Economic Regulation and Public-Private Partnerships, the INTOSAI task force created in relation to the global financial crisis, and also in the working groups of the Contact Committee of the Heads of the Supreme Audit Institutions of the EUROSAI and the European Union continued in a manner similar to 2009. Considering the priority of foreign relations and the limited human and financial resources, the NAO has decided not to participate in any new working groups and in the joint undertakings planned by the Contact Committee of the Heads of the Supreme Audit Institutions of the European Union.

Representatives of the NAO participated in 41 international events outside Estonia: the congress, a conference, seminars, meetings of working groups, training, etc., which covered 388 days in total., incl. people of the Financial Audit Department with 5, representatives of the Local Governments Audit Department with 16, officials of the Performance Audit Department with 112 and people from various services with 255 days. The activities of the NAO were introduced to guests from the Accounts Chamber of the Russian Federation, the European Commission, the OECD, the Parliament of Moldova, the Embassy and Court of Accounts of Turkey, and a week of training was organised for the environmental auditors of the supreme audit institutions of Jordan. We also took part in several surveys carried out by INTOSAI and EUROSAI, gave our opinions of documents presented to the INTOSAI Congress as well as other documents, answered questionnaires about the financial management and auditing of the public sector, cooperated with various international organisations (OECD, UNEP, UNFCCC), etc.

We participated in the annual meeting of the Contact Committee of the Heads of the Supreme Audit Institutions of the European Union and the meeting of representatives of the supreme audit institutions of the Baltic States, Nordic countries and Poland. The director of the National Audit Office is a member of the Peer Review team that carries out the external evaluation of the Supreme Audit Office of Slovakia.

As a result of its international activities carried out in 2010, the NAO strengthened its image of an innovative audit organisation that is prepared to take responsibility and successfully performs its obligations among the supreme audit institutions of other countries and international organisations.

Rein Söörd
International Relations Manager

1.8. Secretariat of the INTOSAI WGEA

The INTOSAI Working Group on Environmental Auditing (WGEA) was established in 1992. The supreme audit institutions of over 70 countries belong to this working group, which is the organisation's largest working group with almost 200 members. The goal of the WGEA is to promote environmental audits in Member States as well as in countries that are not members of the WGEA. The work of the WGEA is led by a Steering Committee, which consists of 17 audit institutions.

The Estonian National Audit Office became the president of the INTOSAI Working Group on Environmental Auditing in 2007. The Secretariat of the WGEA is led by the Director of the National Audit Office, and it employs two senior advisers.

Duties of the Secretariat of the INTOSAI WGEA:

- to coordinate the performance of the working group's work plan and to update it regularly;
- to represent the INTOSAI WGEA at the international level;
- to organise meetings of the Steering Committee of the INTOSAI WGEA etc. and to prepare their materials (incl. the agenda) and minutes;
- to obtain an overview of the environmental audits of Member States and to analyse the development trends of methodology in cooperation with the environmental audit team of the NAO;
- to update and comment on the materials and reports of draft work plans in cooperation with the environmental audit team of the NAO;
- to organise the editing of INTOSAI WGEA project reports in English and translation of the materials submitted to INTOSAI into the five official working languages of the INTOSAI (English, French, German, Spanish and Arabic);
- to administer the database of environmental audits;
- to administer and develop the WGEA website <http://www.environmental-auditing.org>; and
- to edit and distribute the electronic newsletter *Greenlines*.

A work plan was developed for 2008-2010 pursuant to which the INTOSAI WGEA has to launch and carry out five major projects in three years:

- inter-regional parallel audit of climate change (led by Canada);
- regional parallel audits (subjects selected by regions themselves; led by regional coordinators);
- preparation of guidelines for auditing how governments cope with climate change (led by Norway);
- preparation of guidelines for auditing the achievements of governments in implementing sustainable energy (led by the Czech Republic); and
- preparation of guidelines for auditing how governments cope with the performance of environmental requirements in forestry (led by Indonesia), extraction of mineral natural resources (led by Tanzania) and fishery (led by the Republic of South Africa).

2010 was the last in the three-year work period of the INTOSAI Working Group on Environmental Auditing (INTOSAI WGEA) and the main objective was to complete the goals and projects set forth in the work plan three years earlier.

The Secretariat of the INTOSAI WGEA organised two meetings in 2010:

- SC9 (9th meeting of the steering committee) from 15 to 18 February in Tanzania. The objective of the meeting was to review and approve the last versions of all project documents and communication plans. The second main subject covered the work plan for 2011-2013 and the detailed agenda of the meeting of the entire work group (WG13) held in June 2010.
- WG13 (13th meeting of the working group) from 7 to 11 June 2010 in China. The results of the 2008-2010 work period, which focussed on auditing climate change, were summarised at the meeting. Discussion of the guidelines of five environmental audits (climate change, sustainable energy, mining, forestry and fishery) were completed. An overview was given of the results of the 6th environmental survey, and reports on the activities of regions and of the head of the working group were presented. A separate day was dedicated to climate change and the results of the global and EUROSAI climate change audits were introduced. One of the most important subjects for discussion were the work plan for 2011-2013 and its approval for submission to the INTOSAI Congress.

The joint project with UNEP (United Nations Environment Programme) was completed in 2010 and a document about auditing international environmental conventions, Auditing the Implementation of Multilateral Environmental Agreements (MEAs): A Primer for Auditors was issued. The joint report of 14 countries about the results of the climate change audit was also published, and the project was led by the Office of the Auditor-General of Canada.

INTOSAI WGEA published two new websites: how to audit the subjects associated with biodiversity and how to audit climate change. Training materials on how to audit biodiversity were prepared under the guidance of the supreme audit institutions of Brazil and Canada.

The Secretariat of the INTOSAI WGEA is planning to organise the following meetings in 2011:

SC10 (10th meeting of the steering committee) from 8 to 11 March 2011 in Morocco. Its main objective was to approve all project plans for 2011-2013.

WG14 (14th meeting of the working group) from 7 to 11 November 2011 in Argentina.

Tõnis Saar
Head of the Secretariat of INTOSAI WGEA

1.9. Overview of key economic indicators

	2010	2009	2008	2007	2006
Balance sheet indicators					
Assets at end of year	2 914	2 553	5 204	3 746	22 988
Liabilities at end of year	96 023	89 402	85 181	3 628	2 545
Total net assets accrued to state budget at end of year	-93 109	-86 849	-79 977	118	20 443
Income statement indicators					
Operating income	468	46	0	23	333
Operating expenses	63 938	60 860	73 539	62 373	50 327
Operating profit	63 470	60 814	73 539	62 350	49 994
Financial income and expenses	4 813	4 364	0	0	0
Other indicators					
Average number of employees (persons, full-time)	83	86	96	91	94
Budget implementation indicators					
Estimated revenue	0	0	0	0	0
Actual revenue	468	46	0	23	333
Estimated expenditure	59 892	58 282	71 082	64 236	49 070
Actual expenditure	58 503	56 958	71 013	61 930	49 058

Acquisition of TeamMate audit software is the main reason behind the increase in assets in 2006.

The considerable decrease in assets in 2007 was caused by the change in the owner of the NAO's building, land and ventilation and cooling system: the NAO transferred them to the Ministry of Finance, who in its turn transferred it to Riigi Kinnisvara AS.

Since 2008 the occupational pensions earned by the balance sheet date but not paid out to former and working public servants are recognised as provisions on the balance sheet of the state accounting entity where they earned the respective benefit. These were previously recognised on the balance sheet of the Social Insurance Board. Liabilities increased by 77,342,459 kroons as a result of this.

Due to the amendment of the Taxation Act, we recognise 2,252,211 kroons (taxes transferred on salaries paid in December) under both prepayments and liabilities. Pursuant to previous accounting principles, accounts in account group 2030 were debited immediately when taxes were paid, which is why prepayments and tax liabilities were not recognised in the balance sheet.

6% interest on the long-term balance of pension provisions registered in the previous year was recognised under financial expenses in 2009. Increases in the state's old-age pensions of employees have also been recognised as liabilities since 2009.

The reason behind the difference in the budget execution report and the income statement is that the budget execution report is prepared on a cash basis whilst the income statement is prepared on accrual basis.

As a rule, the NAO does not project any revenue for the budget.

The earned revenue consisted of:

- non-monetary targeted financing of training expenses in 2005;
- support received from the Government Office for a project under Measure 1.4 Enhancement of Administrative Capacity in 2006;
- non-monetary revenue of 22,354 kroons received under Measure 1.4 Enhancement of Administrative Capacity and 754 kroons received under the Twinning Project in 2007.
- the 46,164 kroons allocated by EUROSAI for the organisation of the COBIT (Control Objective for Information and Related Technology) seminar was received in 2009; and
- grant of 397,600 kroons received in 2010 from the Government Office under the Development of an Organisation sub-measure of the Increased Administrative Capacity project and a grant of 70,093 kroons received from the INTOSAI Development Initiative.

1.10. Report on the Action Plan for 2010

Strategic objectives: to develop a professional and modern audit organisation and to ensure that our audits contribute to the efficient use of the money and other assets of the state and local authorities.

Indicator: feedback for the NAO's audits received from the auditees and the Riigikogu.

Planned achievement level of the indicators at the end of 2010: 75% of auditees think that the overall quality of the audits is at least good every year.

Actual achievement level of the indicator at the end of 2010: 70% of auditees thought that the quality of audits was at least good. (60% in 2006, 84% in 2007, 50% in 2008, 71% in 2009.)

Explanation of the difference in the anticipated and actual achievement level in 2010: The difference was insignificant compared to the objective.

Indicator: the serious problems highlighted by the NAO have been resolved.

Planned achievement level of the indicator at the end of 2010: Problems have been resolved to the extent of at least 50% as a result of the recommendations made by the NAO (depending on the activities of the auditees). However, we should bear in mind that resolution of some of the problems we have raised takes a long time.

Actual achievement level of the indicator at the end of 2010: ca. 50%. (30% in 2006, 50% in 2008, no data for 2009).

Explanation of the difference in the anticipated and actual achievement level in 2010: A break was taken in the statistical monitoring of the performance of recommendation in 2009 due to the structural changes. The use of follow-up audits has increased considerably in monitoring the performance of recommendations since 2010 (earlier, the NAO collected data in the course of monitoring). As there is no direct keeping of statistics, the achievement level is evaluated on the basis of the reports submitted by the audit departments, which indicate that approximately one-half of the recommendations have been implemented in the reviewed audits.

Indicator: number of certified financial auditors.

Planned achievement level of the indicator at the end of 2010: 5 certified financial auditors.

Actual achievement level of the indicator at the end of 2010: 3 certified auditors (4 in 2007, 3 in 2008, 2 in 2009, 3 in 2010).

Explanation of the difference in the anticipated and actual achievement level in 2010: The target levels of certified auditors were set as goals several years ago at the time when the Authorised Public Accountants Act was still being prepared and the requirements arising therefrom were not yet clear. Said Act was adopted at the beginning of 2010, but the opportunity for professional examinations created with the Act has not yet materialised. The delay is not related to the National Audit Office. The auditors of the NAO have passed a thorough training programme to prepare them for the professional examination. This is why the failure to achieve the specific interim goal set earlier (5 auditors) is not a significant omission at the moment.

Indicator: staff turnover.

Initial level of the indicator or its value at the end of 2008: 14% (18% in 2007).

Planned achievement level of the indicator at the end of 2010: Staff turnover does not exceed 10%.

Actual achievement level of the indicator at the end of 2010: staff turnover was 3% (18% in 2007, 14% in 2008, 19% in 2009).

Explanation of the difference in the anticipated and actual achievement level in 2010: we believe that in addition to the complicated economic situation, the main reason behind this excellent result is the systematic nature and thoroughness of the personnel decisions made in recent years.

Indicator: the NAO achieves its strategic goals and completes its annual work plan.

Planned achievement level of the indicator at the end of 2010: The NAO has achieved the influence objectives set in its strategy in all material respects, and the audits and other activities planned in the work plan at the start of every year have been completed by their deadlines.

Actual achievement level of the indicator at the end of 2010: The achievement of influence objectives has not been separately assessed in 2010. The work plan included 44 audits whose completion was planned for 2010. 38 of them (86%) were actually completed, the rest were postponed until 2011 or excluded from the work plan.

Explanation of the difference in the anticipated and actual achievement level in 2010: the number of audits planned for 2010 was three more than in 2009 despite the change in the number of staff. Some follow-up audits were excluded from the work plan when it became evident that carrying out a full-scale audit would not be practical.

Indicator: external expert assessments of the organisation and audit quality.

Initial level of the indicator or its value at the end of 2008: None.

Planned achievement level of the indicator at the end of 2012: expert assessments show that the NAO is professional and the quality of its work is high.

Planned achievement level of the indicator at the end of 2010: expert assessments show that the NAO is professional and the quality of its work is high.

Actual achievement level of the indicator at the end of 2010: external assessments of audit types which began in 2009 (i.e. financial audits were reviewed and the quality of the majority of reviewed audits was found to be good or satisfactory) continued in 2010 and it is planned to review performance audits in 2011. An opinion on the NAO's audits as a whole cannot be given thus far. Peer Review assessment will probably be postponed due to changed budget conditions.

Explanation of achievement of the goal: The goal of contributing to the more efficient use of state and local government funds was achieved in the form of the completed audits.

Relevant activities and their immediate output

The relevant activity of the NAO is auditing. In its nature, the NAO is an advisory agency that does not exercise power itself, which means that the immediate result of its activities can be the recommendations it gives in the format of audit reports, memoranda or in any other manner.

Relevant activities included in the action plan that were not carried out

Performance audits in the area of defence have come to a halt. The most significant problem in other areas is the postponement of the aforementioned Peer Review, and the completion of several IT projects is also delayed. The main reasons for this are the lack of resources caused by budget cuts (e.g. it has been difficult to find additional auditors for the defence audit team as quickly as necessary; external

assessments, including Peer Review are extremely important, but unfortunately rather time-consuming and expensive – doing them on the account of audit work is not reasonable, etc.).

Overview of improvement of the quality of public services and development of the organisation

Since the beginning of 2009 the NAO has had three departments based on audit types instead of the former five departments, whose structure was agency-based. A number of important audits were completed in 2010, such as the Report of the National Audit Office on the State's Consolidated Annual Report 2009, Overview of the Use and Preservation of State Assets, reports in the impact of the state's enterprise support on competitiveness, sustainability of state forest management, results of packaging waste recovery, distribution of cultural investments, participation of municipalities, towns and cities in companies, etc.

Opinion on completion of the action plan

In 2010 the NAO continued its work in the situation where achievement of the goals set in 2008 had become more difficult due to the reduced budget and the ensuing reduction of staff. Some objectives (e.g. a full-scale Peer Review) have therefore not been achieved due to a lack of resources. All in all, we can say that our action plan was carried out, but on a clearly reduced scale.

2. SPEECHES OF THE AUDITOR GENERAL AND RESPONSE TO THE INTERPELLATION OF A MEMBER OF THE RIIGIKOGU IN 2010

2.1. Speech of Auditor General Mihkel Oviir to the Riigikogu on 27 November 2010

Distinguished President and members of the Riigikogu,

As I take to the rostrum today, I am not representing those who are shedding tears in depression and seeing life in Estonia as a never-ending funeral, but neither am I speaking on behalf of those who live in the midst of illusions and think that everything is hunky-dory.

Between these two extremes is the ordinary life, the real life, and denying its problems may lead to serious consequences.

The task of the National Audit Office is to help decision-makers to understand the real situation, to look at the things going on in the state and its development from a distance, to offer a different angle without using black or rose-tinted glasses.

This angle may disperse many illusions. However, there are times when we have to think about the words of the monk from the cult movie 'The Last Relic' when we take a look at life in Estonia: "Praise the Lord for letting the truth sound like this again!"

The National Audit Office does not take its words as an absolute truth carved in stone, but these words should also not be regarded as some random anonymous comments floating around the Internet.

Our opinions are based on internationally recognised methods of analysis and auditing.

As you all know, the National Audit Office looks into the past only if the past can teach us something for the future. And the members of this as well as the next Riigikogu have a thing or two to learn from 2009.

Ladies and Gentlemen,

Numerous bulky documents have to be studied in order to understand the current situation and trends in public finance, such as the state budget and the explanatory notes; the action plan or what the Government of the Republic hopes to achieve with budgetary funds; all other materials that specify the budget; and the economic forecast that is the basis of the budget.

That is at least 800 pages of material. And its structure is constantly being changed and data are also corrected.

The government's position of advantage in informing the public is rather unshakable in a situation like this. Checking the government's claims is extremely time-consuming even for experienced finance specialists.

The majority of citizens and Riigikogu members are probably unable to assess the situation in public finance without the help of specialists.

I would like to assure you the National Audit Office does not have the capacity or strength to analyse all this down to the minutes detail either. However, we are able to focus on the main problems, especially as we have been monitoring the development of certain subjects for years.

We all know that the rest of the world has admired public finance in Estonia due to three indicators: small public debt, small budget deficit and the existence of reserves.

This admiration is deserved, as we really have been successful in making budget cuts, which shows the determination of our government and the Riigikogu.

But I would like to emphasise that these three indicators do not reveal the whole truth when the sustainability of the state budget is assessed. Things are more complicated than that.

In order to assess how strong and sustainable public finance in Estonia is today and will be in the future, we have to analyse the revenue that the state earns, the way it spends its money and the opportunities of the private sector to re-launch stable economic growth.

The government insists that state budget revenue has increased since 1997, it increased during the recession and will continue to increase this year. I can confirm that the government is telling the truth. But we often forget to put this fact in the correct context: the increase in revenue is not a result of an increase in tax revenue.

Tax revenue, which speaks about the actual health of a state's economy and the welfare of its people, has decreased significantly irrespective of tax increases.

In 2008 tax revenue comprised 83 per cent of the state budget, but its share in the budget had dropped to 74 per cent in 2009. This year the share of tax revenue in total state budget revenue will drop to 72.8 per cent.

The question we have to ask is what has maintained this level of revenue? Where did the increase come from?

The suddenly increased dividends from state-owned companies, increased support from the European Union and other such sources have kept the revenue level high.

The increase in the profits of several state-owned companies and withdrawal of increasing amounts of dividends at the time when the revenue of private companies has decreased makes you wonder whether we are dealing with hidden taxation of people or whether the economic activities of companies are being damaged, if we consider their need to invest.

However, we cannot rely on the amount of this non-tax revenue remaining high in the long term. The Ministry of Finance has already forecast that the amount of state budget revenue will remain the same for the period from 2011 to 2014.

This means that there will be no extra money for the development of various areas.

Again, we have to ask whether the talk about the exceptionally large investments the state is going to make is a lie?

No, it is not. The government is telling the truth again. But once again, we have to put this truth in the right context. We have to admit that we depend largely on the support granted by the European Union.

The state will make two-thirds of investments with the help of foreign funds in 2010.

The most important ministries from the viewpoint of supporting our economy's competitiveness are the Ministry of Economic Affairs and the Ministry of Education, whose total budgets this year contain 50 and 34 per cent of foreign support, respectively.

The Ministry of Environment is the one that carries out major investments and as much as 80 per cent of its expenditure in 2011 is covered by European Union taxpayers and sales of pollution quota.

European Union support, however, is periodic and we cannot rely on it continuing or its amount remaining the same. It is likely that a pause of a couple of years will occur in financing between budget periods.

The audits carried out by the National Audit Office have also shown that when funds are distributed, most of the steam is spent on sticking to rules instead of the lasting benefits these funds should create.

I said it last year and I will say it again: the opportunity to use European Union funds has changed the way we think and feel about money. Suddenly, there is all this money that we did not have to earn, all this easy money.

What we should be thinking about is whether we would be spending money on certain things if it were money collected from our own taxpayers? I think that the answer in many cases would be no.

I would also like to remind you that the things we create with European Union funds have to be maintained with our own tax funds in the future. Do we have enough money for this?

Dear audience,

We just spoke about revenue, but we should also take a look at the state's spending. The government's claim that state budget expenditure is increasing is once again true.

As you know, state budget expenditure can be roughly divided in two: firstly, fixed expenditure, i.e. expenditure, which arises from law and is used to finance a certain social package, the cost of maintaining the public sector and other similar expenditure whose impact is generally not one that develops the state's economy.

The other part of the state's expenditure consists of development expenses or financing new activities and priorities.

However, when we take a closer look at things, we see that the state's expenditure is growing due to the increase in fixed expenditure. The increase in social welfare expenditure is putting particular pressure on the budget.

The state's so-called available funds, which can be flexibly used to support economic growth and new initiatives, will remain on the level of 11 to 12 billion kroons at least until 2014.

I would like to remind you that the state earned 63.7 billion kroons of tax revenue in 2009 and 63.2 billion kroons of this was used to cover fixed expenditure.

As you can see, almost all of our tax revenue is actually used to cover fixed expenditure. This means that money for development has to be found elsewhere.

This fact means that keeping the state budget in balance will become more difficult in the long term, as demographic developments increase social welfare expenditure.

They consume most of the revenue and there is hardly anything left for new investments and economic growth.

So what can we expect to see in the long run? Several case scenarios and predictions have been offered here.

International rating agency Standard & Poor's published its evaluation of the demographic situation in Estonia about a week ago. It shows that the share of working-age people will decrease to 58% of total population by 2050, whilst the current indicator according to the study is almost 68 per cent.

The agency believes that this will cause the share of expenditure relating to aging to increase from the current 2 per cent to 13.5 per cent of GDP. The state will be facing a significant budget deficit and a huge debt.

We can of course convince ourselves that something like this will never happen. Maybe not. We have to wait and see.

Dear audience,

The forecasts of the Ministry of Finance show that from 2010 to 2014, state budget expenditure will exceed revenue by 19.5 billion kroons. The budget expenditure has to be financed one way or another.

The state has decided not to touch its reserves in the nearest future and to borrow instead.

This is why central government debt is increasing. It amounted to 7.7 billion kroons in 2009 and in the opinion of the Ministry of Finance, will amount to 42 billion kroons by 2014. This means that the debt will increase by more than fivefold.

We also have to add the debt of local authorities to this, which is expected to increase from 8.6 billion to 11.1 billion kroons.

Respected Riigikogu member Mart Laar recently said that he broke out in a cold sweat when he read in the annual overview prepared by the National Audit Office that the state is planning to increase its loan burden by five times in years to come.

I, on the other hand, broke out in a cold sweat when I realised that Mart Laar only found out about this by reading the National Audit Office's overview.

Some people have characterised the information given in the National Audit Office's overview with the words 'half-truth' and 'skewed', and added that at least half of the claims made in the overview can easily be disproven.

The Minister of Finance also announced that yes, the claim of the National Audit Office about the significant increase in the loan burden is misleading and he would never sign it.

The chairman of the parliamentary fraction of the party to which the Minister of Finance belongs was even more blunt: "The fivefold increase in the loan burden predicted by the National Audit Office can certainly not be seen anywhere."

I must admit, however, that the data they considered suspicious are not a prediction or fantasy of the National Audit Office. The Minister of Finance himself gave these data two months ago in his economic forecast – page 59, table 22.

And no changes were made in this assessment of the debt burden in the explanatory notes to the draft of the next year's state budget, which was only prepared in September and which also introduces the development of the years following the next.

The information can be found on pages 19 and 20, figures 5 and 6. The debt burden of central government in 2014 according to the forecast is 15% of GDP. Which is almost 42 billion kroons.

The economic forecast of the Ministry of Finance is supposed to be a serious document on the basis of which state budgets are prepared. I would like to remind you that the state budget for 2011, which is currently being discussed, was also prepared on the basis of this forecast.

If the forecast capacity is poor and there is no point in taking the government's forecast seriously, then the Minister of Finance should say so. And he should let us know what other parts of the forecast are not reliable.

It is certainly not a normal situation where the public does not have a single long-term plan that they can believe and members of the government just tell them what their view of things is when they feel like it.

I sincerely hope that the officials who prepared the report will not be asked to make the forecast comply with political statements.

Let me emphasise that if the state is unable to write reliable forecasts, its budget strategy will never be a development plan that is taken seriously and state agencies will find themselves in a situation where the amount of money they can use for the provision of services can change in days.

Saving money on officials who are actually able to prepare forecasts and analyses will cost us all dear in the end. Cuts in the Tax and Customs Board and other similar agencies will also hurt us.

Coming back to the current low debt burden of the state of Estonia, which we are so proud of and justifiably so, we should not forget that the debt burden of our private sector is one of the largest among the new members of the European Union.

It is approximately 101 per cent of GDP or 221 billion kroons. This is an extremely important circumstance, which has a serious impact on domestic consumption, without which we cannot launch our economic development in the long term.

Companies struggle with their loans as their revenue has decreased. There is not enough money to support economic growth, companies have been paying banks more money in loan repayments than they have received in loans for a couple of years now, there is no steam left for development and the continuing insecurity on the markets does not promise anything good.

Estonia did not use the money that flowed into the country during the economic boom for increasing labour productivity, but invested it in property and construction instead. These, however, are not export sectors with high added value.

The high loan burden of the private sectors in Denmark, Germany and Sweden is probably not a problem for them, as their productivity and income are considerably higher than in Estonia.

My goal is not to wear Estonian society out with unpleasant problems, but we have to admit that they exist in order to resolve them. The current revenue and expenditure structure of our state budget is unfortunately not sustainable in the long term.

Dear members of the Riigikogu,

I am not going to start a discussion about who missed the start of the economic crisis and why, as it would not help us much. It is a fact that our economy was in a substantial crisis long before trust started to go missing on the international financial market.

It expressed itself in our poor skills and stimuli of producing something that would help us to keep bread and butter on the table even in hard times.

The question is, would the state have been able to influence the economic structure in some way, or is it doing it today?

I think that the state needs to use all the levers at its disposal smartly in order to support the competitiveness of our economy.

An economy that generates money is a prerequisite to the functioning of a state and the ability of states to support the development of the competitive ability of their companies better is therefore important.

This may mean financial support, but also tax policy measures, negotiations in taking over the requirements of the European Union and using public aid, an accurate legal environment that is not too much of a burden, clever education policy or something else.

All these measures must be analysed from the viewpoint of the problems of different entrepreneurs, because development obstacles in various economic sectors are not the same. I can assure you: not everybody needs money, some still lack qualified workforce, others are held back by certain legislation.

In an audit completed this year the National Audit Office found that the state does not have an enterprise policy, which would cover all the above components as a whole.

Because of this audit, we were accused of claiming that Estonia has no enterprise policy on the basis of just one component of the enterprise policy – enterprise support.

We have not claimed anything like that and anyone who says otherwise is lying. We are talking about a system that is fully comprehensive and considers various elements in their confluence.

The state can develop only if its revenue increases and the only thing that can generate revenue for us is real economy, which means that we have to create an environment for our entrepreneurs that promotes producing maximum revenue and development.

I find stories about quick recovery hard to believe if people's purchase power does not increase for the next year due to the current and maybe even increasing pace of inflation.

Unemployment will also remain high in the nearest future. I see no significant changes in our economic structure when forecasts show that in 2014, the labour of the Estonian people will still be worth just two-thirds of the EU average. This is the forecast of the Ministry of Economic Affairs.

Dear audience,

Although our failure to recognise the crisis made cost-cutting even more difficult, we cannot deny that such a small budget deficit in Estonia in 2009 was unique in Europe. The heads of our state had the courage to strive for the euro and people had the patience to tolerate their decisions.

But do we know what the price of this effort is?

Look, taxpayers' money is not handed over to the government just like that. At least theoretically not. The Government of the Republic approves an action plan at the start of every year where all ministers explain what they plan to do with the money they get from the state budget. At the end of the year, ministers have to report how they did.

Actually, the action plan is changed during the year often and without explanation, and ministers do not speak about approved goals when reporting.

Let me give you an example: the Ministry of Economic Affairs and Communications adjusted the expected labour productivity rate without any explanation from 68 per cent to 60 per cent immediately before the end of the year and a couple of months later, it declared in its report that they have achieved their goal brilliantly – productivity was 60.3 per cent or 0.3 per cent more than planned.

I am once again telling you about the quality of the government's management report and its connection to money, as it is an extremely serious matter.

The government has to assess the impact of its activities. It should do all it can to prevent the emergence of a situation where goals are forgotten or seemingly always achieved.

Of course, we should not be creating artificial activity criteria, which we can then heroically achieve. Only certain things can be measured. We also need preliminary and follow-up analyses of the impact of laws and action plans.

I urge you to demand an action plan from the government that is comprehensive and accompanied by explanations.

We could then see how the 10 billion kroons saved in the state budget have affected the functioning of the state and people.

Dear audience,

The information offered by the National Audit Office cannot come as a surprise to anyone, because we send all of our reports to the parliament, where the state budget control committee and all others should discuss them thoroughly. The reports are also available to everyone on our website.

Although our Riigikogu has sat together for 18 years after the restoration of Estonia's independence, I get the feeling that the nature of the National Audit Office and its relationship with the parliament has remained unclear for many members of the Riigikogu.

I still get the feeling that many members of the parliament look at me with reproach, believing that the National Audit Office should fix one thing or another. This is wrong, wrong, wrong.

The National Audit Office is an independent analyser and collector of information, which works for you and in a broader sense for the state and the taxpayers, but you as the representatives elected by the taxpayers are responsible for acting on the information we give you.

Of course, our respected representatives have the right to do nothing at all. It is your right, but also your responsibility to the taxpayers.

The National Audit Office is one of the information channels of the parliament. We have tried to perform this role for almost two decades now.

My predecessors and myself have received sincere praise as well as constructive criticism for our work in the National Audit Office at the time of different governments and parliament compositions. We are very grateful for this.

As far as I am concerned, this constructive feedback outweighs by a hundred times the cases where some politician announces that a report by the National Audit Office makes them sick or that all we do is drag people through the dirt.

However, there is a certain concern that I simply have to mention – I must admit that in my seven years in this position, I have never experienced such a defensive stance taken by the executive power no matter what the problem that the National Audit Office highlights.

One by one the conclusions drawn from various audits have been declared unusable. And this is done without giving any credible explanations.

Many officials have admitted to us off the record that when asked to prepare a response to an audit conducted by the National Audit Office, they have been given clear politically motivated instructions – deny everything, do not agree with anything.

However, I do not believe that all this comes from some evil plans plotted against the National Audit Office or the fact that politicians are always anxious before impending elections.

It seems to me that it is just a reflection of the broader trends of society and politics on the agencies that I have taken a good look at.

It makes me sad that the prevailing trend in society and political circles is to subconsciously fend off any expressions of thought that are not in line with certain dogmas.

It makes no difference whether they are social, political or something else.

If you dare to say anything that contradicts the slogans of political parties or the comprehension of people who have no analytical skills, you may end up facing the question: so you don't like the Republic of Estonia, do you? Unfortunately, this is a very common level of discussion.

It is extremely regrettable that we keep encountering people whose attitude is to dismiss everything, claiming it's not worthy of discussion. Smash it up and throw it in the bin. I believe this to be a cul-de-sac.

The society of Estonia cannot base its future development on those who tell people what to think or the dogmas of political parties.

Ideas must be analysed and decisions on them should be based on comprehensive and rational analyses of their impact and our possibilities. The attitude that we have no intention of discussing one thing or another is not going to help us progress.

We should discuss education, medicine, taxes, immigration, social welfare, the organisation of state and many other issues calmly, without any hysterics.

We have to lose the legacy of old and inflexible standpoints and free our minds.

However, we should not get carried away with endless discussions, as there always comes a moment when we have to make a decision.

Reforms which are essential for the development of Estonia are currently on hold as people lack the courage to act. You can read more about this in our overview, which was sent to you all two weeks ago. It also gives you information about the situation of local authorities.

In conclusion, I have to say that although our expectations of the development of the state and society of Estonia have been much higher than the results we have seen in actual life, we still have reason to be content.

Our Prime Minister recently said that in comparison to countries that have shared our fate, Estonia has done better than anyone else. I can assure you that this is not an illusion of the Prime Minister. This is the truth. But this knowledge alone is not going to help us go further. Thinking that the state is to blame for everything is also not going to help. Everyone has to take some responsibility. We have to be realistic about what the state of Estonia can do.

I hope we all have enough objectivity and common sense to make Estonia a success. You will be meeting the voters soon.

I thank the present Riigikogu for its cooperation. Thank you!

2.2. Response of the Auditor General Mihkel Oviir to the Riigikogu regarding the Climate and Energy Agency on 20 September 2010.

Dear Chairman, honourable Members of the Riigikogu,

Members of the Riigikogu Kadri Simson, Kalle Laanet, Kalev Kallo, Lauri Laasi, Tiit Kuusmik, Inara Luigas and Toivo Tootsen sent me a query about the Climate and Energy Agency created with the approval of the Riigikogu on 2 June.

The NAO analysed the documents of the agency in order to respond to the query. We also interviewed the director of the agency, the members of the advisory committee and the officials of the Ministry of Economic Affairs and Communications who work in the area of energy. Before I answer your questions, I will briefly explain how the department called the Climate and Energy Agency was established by the KredEx Foundation.

On 18 June 2009 the Riigikogu adopted the resolution with which it made the Government of the Republic the proposal to create the Climate and Energy Agency. According to the resolution, the Government was supposed to submit the programme and foundation documents of the agency to the Riigikogu before its establishment.

The Riigikogu approved the second supplementary budget of the 2009 state budget on the same day. It allocated the Ministry of Economic Affairs and Communications 86 million kroons for energy saving programmes.

The allocated funds were not used in 2009 and the money was transferred to the 2010 state budget. The Minister of Economic Affairs and Communications was inspired by the resolution of the Riigikogu and wanted to speed up the establishment of the agency. At the end of 2009 the minister approved the 15-member advisory committee that gives advice to the Climate and Energy Agency and entered into a contract with the state-owned KredEx Foundation.

A department called the Climate and Energy Agency was founded in the state-owned foundation with the contract. The agreement entered into on 5 January 2010 gave the newly-created KredEx department ca. 86 million kroons from the 2010 state budget.

In the contract, the Minister of Economic Affairs and Communications and the director of KredEx agreed that the Climate and Energy Agency will become an independent institution by the end of the second quarter of 2010 at the latest. The agency has not become independent yet.

The goal set to the agency or the department of KredEx in the contract was to instigate and coordinate research and development activities in the area of energy and climate, to improve the manner in which the state's energy and climate policy is carried out, to develop and implement sustainable development measures and to initiate sample projects.

Now, the first question: What is your opinion of the fact that state budget funds were allocated for the creation of such an agency in the conditions of the current economic crisis? Is it ethical to create an agency that has no clear vision or mission at a time when the unemployment rate in the state is 19.8%?

Let me answer this. The decision on whether or not to allocate money from the state budget, irrespective of the economic situation, is a political choice made by the decision-makers. The NAO cannot express an opinion of this.

All of you here in this hall actually know very well why this idea suddenly came about and why finances were found for it. The NAO evaluates whether the money of taxpayers is used in the best possible manner, i.e. lawfully and effectively.

The NAO has noted in its audits that the lack of truthful information and analysis of the impact of various policies is a significant obstacle in making decisions on important energy policy issues.

The NAO believes that Estonia needs an independent centre of excellence in the area of energy that would have a complete picture of the area and that would also help resolve cross-sectoral problems.

When we evaluate the effectiveness of the Climate and Energy Agency, we have to admit that the kind of agency that was promised in the course of the discussions held in the Riigikogu has not been created.

A department called the Climate and Energy Agency was created in the state-owned KredEx Foundation instead of an agency that could comprehensively manage the area of energy in Estonia.

Although eight months is not long enough for any final conclusions, we unfortunately have to admit that the agency has mainly been looking for projects that it could support. Its main goal, which the creation of the capacity to manage the area of energy comprehensively, has not been achieved.

People who are directly connected to the agency have said that the purpose of granting support is to become an expert in energy-efficient construction via sample projects. At the same time, the agency has not even started dealing with the area of climate. It has still not been explained what the agency's role and cooperation with the ministries that deal with the energy and climate sector and other agencies that distribute support should be.

The director of KredEx who became responsible for the performance of the agency when the contract was signed is responsible for this poor performance. But, as the Minister of Finance Jürgen Ligi also said: nobody knows what this agency is really about.

Question two: Do you believe that such use of the taxpayers' money is rational and in compliance with good public administration practice?

Let me answer this. When we look at the manner in which money was allocated, we have to admit that 86 million kroons was granted for the establishment and operations of the agency without anyone having a clear understand of which tasks it would perform and how it would perform them.

According to the resolution on the establishment of the agency, the Government had to submit the principles of establishment, source documents and the description of the role of the Energy and Climate Agency to the Riigikogu by 15 December 2009 at the latest. The resolution of the Riigikogu was basically ignored. The Government has never discussed the principles, source documents and duties of the Climate and Energy Agency, not to mention their submission to the Riigikogu.

The Riigikogu has therefore allocated money without a clear goal and deprived itself of the option of evaluating whether or not the money is used expediently and effectively. The Riigikogu itself has also reduced the transparency of the state's financial decisions.

Question three: How much has the NAO observed the expedient use of the allocated 86 million kroons?

Let me answer this. In July and August this year the NAO reviewed the resolutions made in the Climate and Energy Agency about the use of money and analysed the organisation of the use of money.

All in all, what we saw was rather worrying.

The advisory committee of the agency had approved the agency's vision document by August. The objectives set therein included the agency becoming an advisory centre on energy and climate policy and a partner of the Government of the Republic and the Riigikogu in energy and climate issues. However, there is no clear action plan or budget for carrying out these good objectives.

Speaking of the budget, I would like to note that the advisory committee has approved the budget, but it does not reflect the use of all 86 million kroons. The decision-making competency of the CEO and the advisory committee has also not been determined.

Projects have generally been supported without the organisation of public competitions and the decisions to support some of the projects are questionable. For example, the advisory committee of the agency decided to use 4.6 million kroons worth of taxpayers' money to build two passive detached houses at the Jõelähtme Golf Centre, which will allegedly be sold later.

4.3 million kroons or 5% of the allocated 86 million kroons has so far been spent or paid out by KredEx. These are the data of the Climate and Energy Agency itself.

The Climate and Energy Agency also sent the NAO an overview of its development and cooperation projects and its contracts as they were in August. This overview indicates that the agency plans to spend ca. 60 million kroons on financial various projects.

Question four: What is your opinion of the election of the agency's director, where the members of the advisory committee of the Climate and Energy Agency only had one candidate to choose from?

Let me answer this. The fact that there was only one candidate for the position of the agency's director does not automatically mean that the advisory committee was deprived of any choice. The advisory committee has the right to not support the candidate. I must say though that I certainly do not approve of the practice where the chairman of the advisory committee suggests that the CEO be appointed without a competition and then presents a candidate who belongs to the same political party as the chairman.

Only one of the eight employees of the agency, the office manager, was hired as a result of a competition, which in the opinion of the NAO is in contravention to good administration practice.

Authorisation contracts have been entered into with two employees. Although these authorisation contracts are basically employment contracts, the costs associated therewith are not recognised as the agency's labour costs.

As we all know from the press, one of the authorisation contracts was entered into with the partner of the chairman of the agency's advisory committee. This person was hired as a development adviser and paid 600 to 1,000 kroons per hour.

I would like to add that the maximum paid by the agency to the adviser for one month so far is 27,000 kroons and in return, the agency has received about a week's worth of work. The report for the working hours in July and August has not been received yet.

I would like to emphasise on the basis of this case that such problematic employment relationships should always be avoided. The fact that everything is actually fair and proper is not enough. Things must also look fair and proper!

Question five: What do you think are the most important duties of the Climate and Energy Agency and why can they not be performed by an institution that already exists?

Let me answer this. The NAO has recommended the establishment of the Climate and Energy Agency in several audits. Similar organisations operate in most European countries, as resolving energy issues comprehensively at the level of ministries is difficult.

First of all, the Climate and Energy Agency should be a centre of excellence that would look at the area of energy and climate as a whole; that could supply quality data and recommendations to policy-makers, who could use that data as the basis of their decisions; who would organise the necessary research, evaluate the effectiveness of energy grants and create a complete vision in significant energy issues. There is currently no institution in Estonia that could perform these duties.

Distributing grants should certainly not be the main activity of the agency. There are enough agencies like that in the state and maintaining another institution that distributes grants would be a waste of taxpayers' money.

However, the agency should help those who distribute money to create such grants and such conditions for granting them that would help the state achieve its energy goals.

There is no reason to hope that these duties could be performed by an agency that operates as a department of a state-owned foundation, and that was established and is basically managed by one political party. Ministries do not want to cooperate with a politicised agency. And this is not my claim, this concern was confirmed to the NAO by the people who are connected with the agency. I guess we have to agree – it is certainly difficult for a cliquey agency to be the policy-maker in the area of energy and climate.

Thank you for your attention.

2.3. Response of Auditor General Mihkel Oviir to the Riigikogu regarding the election advertisement allegedly financed by the Estonian Confederation of Owners on 8 November 2010.

Dear Chairman, honourable Members of the Riigikogu,

A group of Riigikogu members – Helle Kalda, Marika Tuus, Inara Luigas, Vladimir Velman, Nelli Privalova, Olga Sõtnik, Toivo Tootsen, Nikolai Põdramägi and Ain Seppik – have submitted to me a query about the alleged connection between the Estonian Confederation of Owners and the election campaign of the Pro Patria and Res Publica Union. I am going to answer the questions in the order in which they were asked.

Question one: What are the conditions under which the National Audit Office audits the associations financed by the state and has the use of money by the Estonian Confederation of Owners caught the attention of the National Audit Office?

Pursuant to the National Audit Act, the NAO has the right to take procedural steps with regard to persons who receive earmarked allocations granted from the state budget. This is how it can verify the existence of the circumstances serving as the prerequisite for the allocations and the legality of the use of the allocations. Among others, the NAO verifies during its annual financial audits that the allocations granted from the state budget are used for the purpose for which they were granted.

The selection of the audited transactions depends on their importance as well as our risk assessments.

24 million kroons has been prescribed for such allocations in the 2010 budget of the Ministry of Economic Affairs and Communications. The Estonian Confederation of Owners has received allocations from the budget of the Ministry of Economic Affairs and Communications for a total amount of 6.4 million kroons from 2008 to 2010, 2.4 million kroons of this in 2008, 2 million in 2009 and another 2 million kroons this year. In addition to the state budget allocations in the total amount of 6.4 million kroons, the Estonian Confederation of Owners earned revenue in the total amount of 179,200 kroons from 2008 to 2009.

The Confederation of Owners also received a grant of 450,000 kroons from the National Foundation of Civil Society from 2008 to 2009. The payments made to the Estonian Confederation of Owners have not ended up among the transactions audited by the NAO from 2008 to 2010. The NAO took procedural steps after the receipt of the query to verify the circumstances of the use of the allocations granted by the state.

Question two: How does the National Audit Office evaluate the ability of the Ministry of Economic Affairs and Communications to check that the money allocated to the Estonian Confederation of Owners is used correctly both in financial as well as substantive terms?

According to the explanatory memorandum to the Draft 2008 State Budget Act, money was allocated to the Confederation of Owners for the purpose of strengthening civil society. The same reason was also given in the explanatory memorandum to the draft budget act of the subsequent year. All in all, the object of the contracts entered into from 2008 to 2010 was to support the expansion of the Confederation of Owners, protection of the interests of owners and provision of information. The Confederation of Owners and the Ministry of Economic Affairs and Communications had entered into contracts regarding the use of allocations granted from the state budget, which followed the procedure stipulated in the State Budget Act. The Estonian Confederation of Owners did not submit reports on the use of the allocation to the Ministry even though this was required under the contracts. The State Budget Act requires a person who is granted an allocation to keep account of the money allocated from the state budget pursuant to the Accounting Act. The Confederation of Owners has done that.

Pursuant to the State Budget Act, the Ministry has the right to verify the reports, the existence of the circumstances serving as the prerequisite for the allocation and the legality and effectiveness of the use

of the allocation. The Minister of Economic Affairs and Communications approved the procedure for financing the projects of non-profit organisations and foundations with a directive. This procedure does not regulate the verification of the reports to be submitted, i.e. it does not set forth how the expedience of the use of money must be evaluated. The responsible officials of the Ministry confirm that they have checked the compliance of the submitted reports with the established formal requirements. As far as the NAO knows, the Ministry has not identified any inexpedient use of the money.

Question three: Is an association financed from the state budget permitted to distribute material that introduces the members of its management board with the recommendation to vote for them in the upcoming elections?

Allocations granted from the state budget must be used for the activities agreed in the allocation contract or for the achievement of the agreed goals. The person who received the allocation must submit reports on the performance of the contract and in the event of breach of contract, the person who was granted the allocation may be required to return the money. Effective political party law does not prohibit associations to make non-monetary or concealed donations to parties or candidates. However, the Political Parties Act does prohibit political parties from accepting concealed donations and donations from legal entities.

The Political Parties Act stipulates that the sources of a political party's assets and funds are the membership fees established by the political party in its articles of association, donations from natural persons and income on the party's assets. A political party may not accept concealed donations. Concealed donation means giving any goods, services, proprietary and non-proprietary rights to a political party under conditions that are not accessible to other persons. A political party may not accept donations made by legal entities.

All in all, it can be said that an association financed from the state budget is responsible for the use of the money received from the state budget for the purposes agreed in the state budget allocation contract. If any associations has used or uses the allocations granted from the state budget for any purpose other than the one for which it was granted, then this cannot be tolerated.

Last question: Has the Estonian Confederation of Owners financed the election campaign of the Pro Patria and Res Publica Union?

The NAO asked the Estonian Confederation of Owners to provide data about the use of the allocations granted from 2008 to 2010. The information received also covered extracts from accounting documents, bank statements, expense documents and contracts.

The Confederation of Owners submitted bank statements to the NAO. The allocation granted from the state budget was paid to the bank account of the Estonian Confederation of Owners from which payouts were made for the performance of contracts. The revenue earned by the Estonian Confederation of Owners itself and the grant received from the National Foundation of Civil Society were also paid into these accounts. The NAO prepared a sample of all larger transactions, i.e. transactions that exceeded 10,000 kroons, on the basis of the bank statements and reviewed the source documents of these transactions.

All of the requested invoices existed and could be tied to banking transactions. However, some of the contracts that served as the basis for economic transactions had not been entered into in writing, or it was impossible to review their content retroactively.

As a result of the audit, we found that product samples and additional explanations of what had been ordered or distributed, incl. the delivery and receipt certificates of works, confirmations of receipt of services and other such information, had not always been enclosed with invoices. The content of the transactions described on invoices and in contracts was often not specific enough. Product samples

existed on site and they were submitted to the NAO, but in many cases these could not be retroactively linked to any contracts or invoices, i.e. by noting the order or contract list on the invoice or product sample.

The secretary-general of the Estonian Confederation of Owners explained to the NAO which product had been made on the basis of which contract. In the interest of clarity, the NAO advises to consider the implementation of the practice where a description of the ordered work or information of the service is presented with the related invoices and contracts. The secretary-general of the Estonian Confederation of Owners gave an explanation to the auditors of the NAO pursuant to which the association has not used the money allocated by the state to support the election campaign of any political party or candidate either directly or indirectly. No logos of political parties were depicted on any of the printed material submitted to the NAO.

Also, the *Koduomanik* newspaper did not mention which political party the persons who wrote in the newspaper belonged to. The NAO found no evidence that the Confederation of Owners has used the money allocated by the state to finance the election campaign of a political party or candidate.

As for the leaflets that displayed photos of Riigikogu members Urmas Reinsalu and Ken-Marti Vaher that were distributed at the end of summer, which led to the submission of this query, then these members of the Riigikogu have voluntarily submitted expense documents to the NAO, which prove that they paid for their advertising materials themselves.

Thank you for your attention!

3. ANNUAL ACCOUNTS

Balance sheet

(thousand kroons)

	Note	31.12.2010	31.12.2009
Assets			
Current assets			
Other receivables and prepayments	4, 5	2 234	1 508
Total current assets		2 234	1 508
Fixed assets			
Tangible fixed assets	6	626	445
Intangible fixed assets	7	54	600
Total fixed assets		680	1 045
Total assets		2 914	2 553
Difference between assets and liabilities		93 109	86 849
Payables			
Current liabilities			
Trade creditors	5	155	87
Employee-related payables	5	3 734	3 402
Other payables and prepayments received	3, 5	1 588	1 357
Provisions	5, 8	4 467	4 338
Total current liabilities		9 944	9 184
Long-term liabilities			
Provisions	5, 8	86 079	80 218
Total noncurrent liabilities		86 079	80 218
Total liabilities		96 023	89 402
Net assets		0	0

Income statement

(thousand kroons)

	Note	2010	2009
Operating income			
Targeted financing related to operating expenses		468	46
Total operating revenue		468	46
Operating expenses			
Grants awarded	9	-14	-14
Staff costs	10	-47 282	-47 217
Management costs	11	-13 655	-10 923
Other operating expenses	12	-2 117	-1 676
Depreciation of fixed assets	13	-870	-1 030
Total operating expenses		-63 938	-60 860
Operating profit		-63 470	-60 814
Financial income and expenses			
Interest expenses	8	-4 813	-4 364
Profit/loss for financial year		-68 283	-65 178
Net financing from state budget	14	68 283	65 178

Cash flow statement

(thousand kroons)

	Note	2010	2009
Cash flow from operating activities			
Operating profit		-63 470	-60 814
Adjustments			
Depreciation of fixed assets	6, 7	870	1 030
Total adjusted operating result		-62 600	-59 784
Net change in current assets		-725	1 790
Net change in liabilities		1 678	-2 955
Total cash flow from operating activities		-61 647	-60 949
Cash flow from investing activities			
Paid on acquisition of tangible and intangible fixed assets	6, 7	-506	-169
Total cash flow from investing activities		-506	-169
Cash flow from financing activities			
Net financing from state budget	14	62 153	61 118
Total cash flow from financing activities		62 153	61 118
Net cash flow		0	0
Cash and cash equivalents at beginning of period		0	0
Cash and cash equivalents at end of period		0	0
Change in cash and cash equivalents		0	0

Report on changes in net assets

(thousand kroons)

	Note	Total
Balance as of 31.12.2009		-79 977
Changes in accounting policies and procedures		-2 812
Transfer from elimination of result	14	-4 060
Total changes		-6 872
Balance as of 31.12.2009		-86 849
Changes in accounting policies and procedures		-10
Transfer from elimination of result	14	-6 250
Total changes		-6 260
Balance as of 31.12.2010		-93 109

Pension provisions are recognised under changes in accounting policies and procedures.

State budget execution report

(thousand kroons)

Code	Name	Estimated budget 2010	Actual budget 2010	Implementation of actual budget 2010	Actual execution less final budget	Transferred to 2011
		<i>A</i>	<i>B</i>	<i>C</i>	<i>C-B</i>	<i>D</i>
Receipt of income						
35	Grants received	0	468	468	0	0
Total revenue received		0	468	468	0	0
Payment of expenses						
15	Acquisition and renovation of tangible and intangible assets	-670	-670	-607	63	-63
4	Provisions	-14	-14	-14	0	0
50	Operating expenses	-57 421	-59 208	-57 882	1 326	-1 295
Total payment of expenses		-58 105	-59 892	-58 503	1 389	-1 358
Financing from state budget				58 990		0
Transfers to state budget				-955		0
Cash and cash equivalents at end of period				0		0

Own revenue in 2010 comprised of 397,600 kroons received in 2010 from the Government Office under the Development of an Organisation sub-measure of the Increased Administrative Capacity project and a grant of 70,093 kroons received from the INTOSAI Development Initiative.

The report on the cash-based execution of the budget is not comparable to the income statement in terms of expenditure. The income statement is prepared according to the requirements of accrual-based accounting.

Notes to annual accounts

Note 1. Accounting policies and procedures used in preparation of the annual accounts

The annual accounts of the National Audit Office are prepared in compliance with the State Budget Act and the accounting principles generally accepted in Estonia. The generally accepted accounting principles are based on internationally recognised 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 acquisition cost principle is used in the preparation of the annual accounts.

The estimates set out in the annual accounts are presented in thousands of Estonian kroons.

Classification of assets and liabilities as current and non-current

Assets and liabilities are classified as current or non-current on the balance sheet depending on whether the expected possession of the asset or liability in question is expected to last for up to one year or longer after the balance sheet date.

Taxes, fees, fines and other receivables

Taxes, fees, fines and other claims are recognised on the balance sheet using the adjusted acquisition cost method. Receivables are recognised at the moment the right of claim emerges and are estimated in consideration of the amounts likely to be received.

Tangible fixed assets

Tangible fixed assets are assets whose estimated useful lives exceed one year and whose acquisition cost is at least 30,000 kroons. Tangible fixed assets whose acquisition cost is 10,000 to 29,999 thousand kroons that are registered as tangible fixed assets are written off the balance sheet via depreciation expenses in 2010 on the basis of Regulation No. 71 of the Minister of Finance dated 28 December 2009. Assets with a useful life of more than one year and with an acquisition cost of less than the limit set for registration of fixed assets are immediately put into use and written off as of the moment they are put into service.

The acquisition cost of fixed assets includes expenses which are necessary for utilising the assets, except the taxes, fees, credit, training and travel expenses related to the acquisition of fixed assets, which are recognised as expenses for the financial year when incurred.

Fixed asset reconstruction expenditure, which complies with the definition of tangible fixed assets, is added to the cost of fixed assets.

Fixed assets are recognised at their acquisition cost less accumulated depreciation and any possible write-downs resulting from impairment. The linear method is used for depreciation. Depreciation rates are set separately for all items of fixed assets depending on their useful lives.

The annual depreciation rates applied to fixed asset groups are as follows.

- | | |
|---------------------------|-----|
| ▪ structures | 7% |
| ▪ machinery and equipment | 20% |
| ▪ ICT equipment | 33% |

- other fixtures, tools and fittings 20%

Intangible fixed assets

Intangible fixed assets are assets without physical substance whose estimated useful lives exceed one year and whose acquisition cost is at least 30,000 kroons. Intangible fixed assets whose acquisition cost is 10,000 to 29,999 thousand kroons that are registered as tangible fixed assets are written off the balance sheet via depreciation expenses in 2010 on the basis of Regulation No. 71 of the Minister of Finance dated 28 December 2009. Assets with a useful life of more than one year and with an acquisition cost of less than the limit set for registration of fixed assets are immediately put into use and written off as of the moment they are put into service. Intangible fixed assets are recognised at their acquisition cost less accumulated depreciation and any possible write-downs resulting from impairment. Intangible fixed assets are generally depreciated within four years using the linear method.

Assets taken on lease

Capital lease is a lease where all significant risks and benefits related to the ownership of the asset in question are transferred to the lessee. Other leases are recognised as operating leases.

Operating lease payments are recognised evenly as expenses during the lease period.

Provisions and contingent liabilities

Liabilities incurred before the balance sheet date which have a legal or contractual basis or arise from the current practice of the accounting entity and require the relinquishment of assets and the amount of which can be determined in a reliable manner, but the final cost or payment deadline of which has not been fixed, are recognised as provisions on the balance sheet. Provisions are assessed on the basis of the management's assessments and experience and, if necessary, opinions of independent experts. Long-term allocations are discounted at a rate of 6%.

Special occupational pension benefits and pension increases guaranteed to employees on the basis of law are recognised as pension provisions. The amount of pension provisions as of the balance sheet date is calculated separately for retired employees and current employees. Occupational pensions and pension increases are recognised as expenses using the proportional crediting method, according to which each period of service generates an additional unit for receiving a pension pursuant to the length of service required for receiving the pension. The data of Statistics Estonia regarding the average life expectancy and the evaluations of the Ministry of Finance regarding changes in average pensions in the periods to come are used for the calculation of pension provisions. In respect of employees, it is also assessed how many leave work before they qualify for a special pension or pension increase.

As of 31 December 2008, occupational pensions earned by the balance sheet date but unpaid to former and working public servants were recognised as provisions on the balance sheet of the state accounting entity from whom they earned the benefit (§ 48 of the General Rules of State Accountancy). These were previously recognised in the balance sheet of the Social Insurance Board. Pension increases for current employees are calculated on the basis of § 57 of the Public Service Act as of 31 December 2009.

Promises, guarantees and other commitments that can become liabilities in the future under certain circumstances are disclosed as contingent liabilities in the notes to the annual accounts.

Recognition of foreign currency transactions

Foreign currency transactions are recognised using the official exchange rates quoted by the Bank of Estonia on the date of the transaction. Monetary financial assets and liabilities denominated in foreign currencies and non-monetary financial assets and liabilities recognised at fair value are restated in Estonian kroons on the balance sheet date, using the official exchange rates of the Bank of Estonia

quoted on the balance sheet date. Gains and losses on foreign currency transactions are recognised on the income statement as income and expenses for the period.

Expense records

Expenses are recognised on the accrual basis. Non-refundable taxes and fees related to the acquisition of fixed assets or inventories are recognised at the moment of acquisition as expenditure, not as the acquisition cost of assets or inventories.

Net financing from state budget and net assets

The state's financial resources are managed by the State Treasury of the Ministry of Finance, which grants money to state agencies to make transfers and obtains the money received by state agencies from them. The respective transfers are recognised as net financing from the state budget. Other mutual transfers of assets, liabilities, revenue and expenditure with other state accounting entities are also considered net financing from the state budget.

Additional non-monetary transfer with the State Treasury, which takes the income statement to zero, is recognised for full transfer of the profit or loss. It is also recognised as a change in net assets (alternative between assets and liabilities). The revenue and expenditure not recognised on the income statement (such as revaluation of fixed assets) is recognised directly as a change in net assets (with the difference between assets and liabilities as the alternative).

Events after the balance sheet date

The annual accounts recognise the material circumstances which influence the evaluation of assets and liabilities and which occurred between the balance sheet date and the preparation date of the annual accounts, which is 31 March 2010, but which relate to transactions that occurred during the accounting period or previous periods.

Events after the balance sheet date which were not considered in the evaluation of assets and liabilities but may have a considerable impact on the results of the next financial year are disclosed in the notes to the annual accounts.

State budget execution report

The state budget execution report is prepared on the basis of the data in the e-State Treasury programme on a cash basis. The statement is based on the principles considered in the preparation of the state budget, which may differ from accounting policies and procedures. The main differences in addition to the cash-based principle are as follows:

- no internal eliminations are made in the state accounting entity;
- the value added tax payable on the acquisition of goods and services is recognised with the costs of the goods and services i.e. as management expenses as well as acquisition of fixed assets, not separately as other expenses;
- acquisition of tangible and intangible fixed assets is recognised as expenditure and the income earned on sales of these assets is recognised as revenue, while depreciation of fixed assets, re-evaluations and other non-monetary movements are not recognised; and
- money transferred to other state agencies and money received from them is recognised as provisions and as grants received (in accrual-based reporting as net financing from the state budget).

Note 2. Cash and cash equivalents

The State Treasury makes transfers from the NAO's budget and services all receipts belonging to the NAO. The NAO did not use any accounts outside of the group account in 2010.

Note 3. Transactions with public sector and associated entities

3.A. Claims and liabilities

(thousand kroons)

	Current receivables	Current liabilities
As of 31.12.2009		
State accounting entities (see Note 4, 5)	616	1 338
Foundations, NGOs and companies belonging to the government sector	75	1
Total public sector entities	691	1 339
Total public sector and associated entities	691	1 339
As of 31.12.2010		
State accounting entities (see Note 4, 5)	915	1 585
Total public sector entities	915	1 585
Total public sector and associated entities	915	1 585

3.B. Revenue and expenditure

(thousand kroons)

	2010		2009	
	Operating income	Operating expenses	Operating income	Operating expenses
State accounting entities	398	2 199	0	1 672
Local authorities	0	31	0	14
Other legal persons in public law	0	922	0	222
Foundations, NGOs and companies belonging to the government sector	0	5 151	0	3 093
Total public sector entities	398	8 303	0	5 001
Associated entities	0	0	0	184
Total public sector and associated entities	398	8 303	0	5 185

Note 4. Taxes, fees and fines receivable and payable

(thousand kroons)

	Prepayments	Current liabilities
As of 31.12.2009		
Taxes		
Social security tax	0	792
Income tax	0	433
Unemployment insurance premium	0	91
Income tax on fringe benefits	0	22
Prepaid	616	0
Total taxes (see Note 3.A, 5)	616	1 338
As of 31.12.2010		
Taxes		
Social security tax	0	924
Income tax	0	506
Unemployment insurance premium	0	107
Funded pension	0	24
Income tax on fringe benefits	0	24
Prepaid	915	0
Total taxes (see Note 3.A, 5)	915	1 585

Note 5. Other receivables and payables

(thousand kroons)

	31.12.2010		31.12.2009	
	Current portion	Non-current portion	Current portion	Non-current portion
Receivables and prepayments made				
Prepaid taxes (see Note 3.A, 4)	915	0	616	0
Prepaid expenses	1 319	0	892	0
Total other receivables and prepayments made	2 234	0	1 508	0
Liabilities and prepayments received				
Taxes payable (see Note 4)	1 585	0	1 338	0
Trade creditors and employee-related payables	156	0	87	0
Holiday pay payable	3 733	0	3 402	0
Other payables (see Note 8)	4 470	86 079	4 357	80 218
Total other payables and prepayments received	9 944	86 079	9 184	80 218

The holiday pay payable includes social tax and the unemployment insurance premium.

The current portion of other payables in 2009 comprises pension provisions payable next year to retired employees in the amount of 3,999,744 kroons and to current employees in the amount of 338,688 kroons, and credit card expenses for December.

The non-current portion of other payables consists of pension provisions payable, where 48,124,006 kroons has been calculated for retired employees and 29,282,111 for current employees, and the pension increase for current employees of 2,811,704 kroons as stipulated in the Public Service Act.

The current portion of other payables in 2010 contains pension provisions payable next year to retired employees in the amount of 4,128,768 kroons and to current employees in the amount of 338,688 kroons, and credit card expenses for December.

The non-current portion of other payables consists of pension provisions payable, where 52,863,335 kroons has been calculated for retired employees and 34,266,927 for current employees, and the pension increase for current employees of 3,415,813 kroons as stipulated in the Public Service Act.

Note 6. Tangible fixed assets

(thousand kroons)

	Structures	Machinery and equipment	Other fixed assets	Total
Book value as of 31.12.2009				
Acquisition cost	303	1 903	2 164	4 370
Accumulated depreciation	-152	-1 688	-2 085	-3 925
Residual value	151	215	79	445
Changes in 2010				
Acquisitions and improvements	0	451	0	451
Write-off	0	-760	-413	-1 173
Depreciation (see Note 13)	-60	-178	-31	-269
Reclassification of depreciation	0	760	412	1 172
Total changes	-60	273	-32	181
Book value as of 31.12.2010				
Acquisition cost	303	1 594	1 751	3 648
Accumulated depreciation	-212	-1 106	-1 704	-3 022
Residual value	91	488	47	626

Machinery and equipment

The virtual server platform and data storage were purchased in 2010.

Machinery and equipment whose acquisition cost totalled 760,813 kroons were written off in 2010. These included four servers whose acquisition cost totalled 691,321 kroons and assets that had been registered earlier and whose acquisition cost ranged from 10,000 to 29,999 kroons and totalled 69,492 kroons.

Other fixed assets

Other fixed assets with an acquisition cost of 413,634 kroons were written off in 2010. These include a door locking system with an acquisition cost of 48,000 kroons, unusable furniture with an acquisition

cost of 17,780 kroons and previously registered assets whose acquisition cost ranged from 10,000 to 29,999 kroons and totalled 347,854 kroons.

Note 7. Intangible fixed assets

(thousand kroons)

Intangible fixed assets	Software	Total
Book value as of 31.12.2009		
Acquisition cost	2 580	2 580
Accumulated depreciation	-1 980	-1 980
Residual value	600	600
Changes in 2010		
Acquisitions and improvements	55	55
Write-off	-13	-13
Depreciation (see Note 13)	-601	-601
Reclassification of depreciation	13	13
Total changes	-546	-546
Book value as of 31.12.2010		
Acquisition cost	2 622	2 622
Accumulated depreciation	-2 568	-2 568
Residual value	54	54

Virtualisation software licenses were acquired in 2010. Old accounting software Tresoor with an acquisition cost of 13,051 kroons was written off in 2010.

Note 8. Provisions and contingent liabilities

(thousand kroons)

Provisions	At beginning of period	Used during period	Cancelled/added during period	Interest expenses calculated	At end of period
2009					
Pension provisions,	77 609	4 206	6 789	4 364	84 556
incl. provision for public service pension increase	0	0	2 812	0	2 812
Total,	77 609	4 206	6 789	4 364	84 556
incl. current	4 866	4 206	3 678	0	4 338
non-current	72 743	0	3 111	4 364	80 218
2010					
Pension provisions,	84 556	4 118	5 295	4 813	90 546
incl. provision for public service pension increase	2 812	0	604	0	3 416
Total,	84 556	4 118	5 295	4 813	90 546
incl. current	4 338	4 118	4 247	0	4 467
non-current	80 218	0	1 048	4 813	86 079

The 31 current recipients of the NAO's occupational pension, the 13 persons who will qualify for the NAO's occupation pension in future and the 89 current employees for whom a pension increase was calculated on the basis of the Public Service Act were considered in the formation of pension provisions.

The pension to be paid out next year is indicated as a current liability. The non-current liability is discounted by 6%. The interest expenses calculated on the balance of non-current pension provisions registered as of 31 December 2009 is 6%.

Off-balance sheet contingent liabilities	31.12.2009	31.12.2010
Lease obligations assumed	1 545	1 412
Total	1 545	1 412

Contingent liabilities comprise the rent for 3 months calculated for Riigi Kinnisvara AS and the contract termination fee payable to Rent Eesti OÜ and ALD Automotive Eesti according to the contract. Riigi Kinnisvara AS was paid rent for the building in the amount of 3,258,276 kroons in 2009 and 5,224,915 kroons in 2010. Lease payments for means of transport amounted to 253,249 kroons in 2009 and to 212,840 kroons in 2010. The compensation payable to the audit general at the end of his term in office, which equals his salary for 6 months, will be added in 2013.

Note 9. Grants awarded

(thousand kroons)

Average number of employees	2010	2009
EUROSAI	7	7
INTOSAI	7	7
Total membership fees	14	14

The NAO is INTOSAI member as of 1992 and EUROSAI member as of 1993.

Note 10. Labour costs

(thousand kroons)

	2010	2009
Salaries and wages of public servants	29 164	30 384
Salaries and wages of employees	178	224
Salaries and wages of elected and appointed officials	817	766
Salaries and wages of temporary staff working under contracts	628	466
Non-staff salaries and wages	15	13
Occupational pensions and pension increases	5 164	3 977
Total salaries and wages	35 966	35 830
Fringe benefits	421	343
Social security tax	10 351	10 669
Unemployment insurance premium	417	272
Income tax on fringe benefits	127	103
Total labour costs	47 282	47 217

Average number of employees	2010	2009
Officials in public service	81	84
Employees	1	1
Elected and appointed officials	1	1
Total	83	86

Pay calculated for top executives and management

(thousand kroons)

Positions	2010	2009
	Pay	Pay
Auditor General	787	826
Director	843	672
Directors of audit	1 979	1 910
Total	3 609	3 408

Staff costs contain the holiday pay payable to employees.

Note 11. Management costs

(thousand kroons)

	2010	2009
Administration expenses	2 258	2 345
Research and development	324	518
Travel expenses	1 448	1 319
Training expenses	1 081	343
Cost of managing registered immovables, building premises	5 008	2 866
Vehicle maintenance expenses	416	442
ICT costs	2 584	2 857
Costs of managing fixtures, fittings and tools	376	207
Medical expenses	160	26
Total	13 655	10 923

Note 12. Other operating expenses

(thousand kroons)

	2010	2009
Exchange rate differences	6	4
Value added tax	2 111	1 672
Total	2 117	1 676

Note 13. Depreciation and revaluation of fixed assets

(thousand kroons)

	2010	2009
Depreciation of tangible fixed assets (see Note 6)	269	305
Depreciation of intangible fixed assets (see Note 7)	601	725
Total	870	1 030

Note 14. Net financing from state budget

(thousand kroons)

	2010	2009
Net financing from state budget		
Received from State Treasury for transfers	58 990	56 977
Transfers to state budget	-955	-65
Intra-entity transfers received	4 118	4 206
Total net financing from state budget	62 153	61 118
Non-cash transfers with other state accounting entities		
Received from other state accounting entities	20	0
Transferred to other state accounting entities	-140	0
Total non-cash transfers	-120	0
Net financing from state budget for elimination of operating result	6 250	4 060
Total net financing from state budget	68 283	65 178

Note 15. Formation of the final budget

(thousand kroons)

	Income	Expenditure
Initial budget	0	-58 105
Transferred from previous year	0	-1 319
Grants actually received	468	-468
Total final budget	468	-59 892

Note 16. Events after balance sheet date

Estonia joined the Eurozone on 1 January 2011 and the Estonian kroon was replaced with the euro. Accounting data were converted into euros as of this date. Financial statements are prepared in euros from 2011. Reference data are converted using the official exchange rate of 15.6466 Estonian kroons for one euro.

4. OPINION OF THE NAO'S INTERNAL CONTROL SYSTEM

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

The NAO's internal control system covers the NAO's structure, management attitudes, applicable procedures and other measures, which give reasonable assurance that:

- the NAO's operations are legitimate;
- the NAO's assets are protected from damage resulting from squandering, inexpedient use, fraud, incompetent management etc.;
- the NAO conducts its business economically, efficiently and effectively, and the high quality of services is guaranteed; and
- the management and financial information about the NAO's business is reliable, accurate and timely.

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

Mihkel Oviir
Auditor General

5. SIGNATURES TO THE ANNUAL REPORT

The Annual Report of the NAO for the financial year ended on 31 December 2010 consists of the management report, annual accounts and an opinion on the accuracy of the report and the legality of transactions.

The executive management of the NAO prepared the management report and the annual accounts. The Auditor General and the Director have examined the report and approved it for submission to the Riigikogu.

Mihkel Oviir
Auditor General

Tõnis Saar
Director of the National Audit Office

18 April 2011

6. INDEPENDENT AUDITOR'S STATEMENT