

Accuracy of Annual Report 2014 and regularity of transactions of the state

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Summary of audit results

What did we audit?

Every year the National Audit Office (NAO) audits the state's annual accounts as well as the annual accounts of ministries, the Government Office and constitutional institutions. Further, the NAO examines whether state agencies have performed their economic transactions in compliance with the most important legislation in the field: the State Budget Acts, the State Assets Act and the Public Procurement Act. In that context, the NAO expresses an opinion as to whether the budget acts have been adhered to in the performance of economic transactions. The most significant observations about omissions detected in transactions with state assets and in public procurements are set out in the audit report.

What was the scope of our audit?

In addition to the indicators of state accounting entities, the annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and the profit-making state agency. Certified auditors from audit firms have audited the annual accounts of these entities, and the NAO has taken their opinion into account in expressing an opinion on the state's annual accounts.

The NAO did not carry out audit procedures to check the additional information about local authorities, the public sector and the government sector disclosed in the Consolidated Annual Report of the State.

Why is this important for the taxpayers?

By auditing the state's annual accounts the National Audit Office provides assurance that the accounting indicators presented to the Riigikogu and the public give true information about the state's financial position and performance results for the year ended and that the State Budget Execution Report gives relevant information about the state's revenue and expenditure and investments made at the account of this revenue.

According to the 2014 State Budget Execution Report, the revenue collected by the state in 2014 amounted to 7.9 billion euros, which exceeded the revenue of 2013 by 206 million euros. The expenditure and investments incurred by the state amounted to 7.8 billion euros, which exceeded the expenditure of 2013 by 196 million euros. In 2014, the revenue exceeded expenditure by 41 million euros (NB! It is not a surplus or deficit of the government sector which is calculated using other calculation methods - for more information see the management report within the 2014 Consolidated Annual Report of the State).

According to the consolidated annual accounts of the state, the assets of the state as of 31 December 2014 amounted to 15.4 billion euros and the majority of the assets were fixed assets. Compared to the previous period, the value of assets has increased by 3 billion euros, mainly on the account of the adjustment of the discount rate use for the valuation of biological assets (state forests).

As at 31 December 2014, the state's liabilities totalled 6.3 billion euros - an increase of 0.9 billion euros compared to the previous period. Long-term liabilities of 4.7 billion euros comprise the majority of liabilities and the increase in them was mainly caused by the growth of long-term pension provisions (amounting to 1.8 billion euros) and long-term loans payable (amounting to 2.8 billion euros).

What did we find and conclude based on the audit?

The 2014 Annual Accounts of the State are correct in all material respects, which means that they give a true and fair view of the state's financial position as well as its financial performance and cash flow for the year ended.

The accounting of state agencies, state-controlled foundations and state-owned companies is well managed in most part and the annual accounts are largely free of material errors.

The NAO is of the opinion that the state's economic transactions were performed in all material respects in accordance with the State Budget Act, the 2014 State Budget Act and its amendment act. This means that the NAO did not find any significant errors in the implementation of the State Budget Acts.

The main observations of the NAO are as follows:

- The state budget execution report is not sufficiently transparent for its users. Although the presentation of that report has improved, it still features shortcomings. The state budget execution report shows the funds carried forward from the preceding financial year in the column "Final budget" which makes them indistinguishable from the expenses for the accounting year. Therefore, the reader of the report is unable to learn how much money remained unused in the ministries during the preceding and the accounting year, and for what purposes it was allocated and why was it not used. The notes to the report provide no explanations either.
- The amount envisaged in the annual state budget for financing the core activities of the Ministry of the Environment do not reflect completely the amount of money spent on the Ministry's activities, because core activities are annually financed on project basis from the Environment Investment Centre as well.
- Year by year, the number of state agencies which inaccurately plan revenue and expenditure in the budget and incorrectly determine the economic substance of transactions has decreased. The NAO ascertained that some state agencies had incorrectly determined the economic substance of transactions and made investments from the funds designed for management expenses, and the other way round. Such irregularities were most abundant within the government area of the Ministry of Culture.

- Consistent irregularities have occurred in the budgeting of long-term lease contracts because the long-term liabilities arising out of financial lease contracts have not been envisaged as financing transactions in the budget. According to the State Budget Act, the state agencies may effect expenditure only if the budget provides for funds to this end. The State Budget Act prohibits the state agencies from borrowing, using finance lease and assuming other long-term liabilities unless provided for in the annual state budget. Hence, if there is a need to carry out financial lease transactions, these should be envisaged within the annual budgeting process as financing transactions. The current situation is that state agencies have in principle effected transactions which the Riigikogu has not authorised during the annual budget approval procedure.
- Overall, the state agencies have respected the principles laid down in the State Assets Act as regards transactions with state assets. However, it is in conflict with the State Assets Act that several state agencies have become members of non-profit associations without the approval of the Government of the Republic.
- Compared to the previous years, there are less violations of the Public Procurement Act. Nevertheless, not all state agencies have respected the rules set out in the Public Procurement Act for the procurement of goods and outsourcing of services.

What did we recommend as a result of the audit?

Important recommendations of the NAO to the Minister of Finance and the Minister of Public Administration:

- disclose, in a separate column of or notes to the state budget execution report, the funds carried forward from the preceding financial year to the accounting year, broken down by the ministries - similarly to funds carried forward to the following year;
- outline, in the consolidated annual report of the state, justifications for carrying forward significant amounts from the accounting year to the following year, and include a reference to the location of more detailed information;
- plan, on uniform basis and in full amount, the funds of all ministries necessary for the performance of statutory functions within their respective budgets;
- ensure that the agencies would identify the commitments arising from financial lease contracts as financing transactions;
- determine, in collaboration with the ministries governing the participating holdings, the objectives of participating in non-profit associations and whether participation in all such associations is justified.

The Minister of Finance and the Minister of Public Administration agreed with the recommendations made by the NAO.

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Opinion on the regularity of transactions in 2014

Compliance with State Budget Acts

Predominantly, the budget funds were used in accordance with the State Budget Acts

1. According to the State Budget Execution Report the revenue collected by the state in 2014 amounted to 7.9 billion euros, and expenditure incurred by the state amounted to 7.6 billion, investments to 0.3 billion, and financing transactions to 0.2 billion euros. The National Audit Office is of the opinion that the state's economic transactions were performed in all material respects in accordance with the State Budget Act, the 2014 State Budget Act and its amendment act.

Limitation of audit scope

Did you know that

According to the Authorised Public Accountants Act which entered into force in 2010, the audit of regularity of transactions is mandatory for companies where the state holds at least a required interest as defined in the State Assets Act, and for state-established foundations and profit-making state agencies.

The regularity of economic transactions has not been audited in all state-controlled foundations and state-owned companies

2. In order to provide an opinion on the regularity of transactions, the NAO must obtain assurance that the transactions of entities consolidated in the annual report of state have been effected legitimately. In addition to state agencies, the consolidated entities (hereinafter "entities") include government-invested companies, state-established foundations and the profit-making state agency (State Forest Management Centre). The NAO itself conducts audit operations at state agencies whereas foundations, companies and the profit-making agency are audited by certified auditors from audit firms.

3. Not all certified auditors who provided an opinion on the annual accounts of state-owned companies, state-controlled foundations and the State Forest Management Centre have audited the regularity of transactions of these entities. Regularity has not been audited because in 2014 some entities had outsourced auditing services on the basis of contracts which did not comprise auditing the regularity of transactions. Certified auditors have audited regularity in a total of eight companies and foundations. However, regularity was not audited in such major companies like Eesti Energia and Tallinna Sadam or foundations like KredEx and the Environmental Investment Centre.

4. The NAO has not conducted additional audit procedures in these entities to assess the legality of transactions meaning that the audit scope is limited in that regard. The NAO finds it impractical to conduct these operations by itself as in the long run it would lead to the duplication of the efforts of certified auditors.

5. The NAO has addressed letters to entities whose contracts for auditing services were about to expire highlighting that when concluding new contracts the audit of regularity of transactions must be outsourced too.

The presentation of the state budget execution report could be improved

6. In its earlier audits, the NAO has criticised the presentation of state budget execution reports and pointed out that these reports cannot be compared against the annual state budget adopted by the Riigikogu. Since 2013, the Riigikogu has adopted the annual budget in the new format and

State budget execution report

the same representation has been used in reporting on the implementation of the state budget. Consequently, the budget adopted by the Riigikogu and the state budget execution report are comparable which facilitates the comprehension and usage of information presented in the said report.

Funds carried forward

Carry-forward of state budget funds

means extending the time limit for using the state budget funds by a period of one budgetary year. The state budget funds are divided into funds with limits and funds without limits. For funds with limits, investments and grants are carried forward in full, and up to three percent of expenditure.

7. Regardless of the aforesaid, the presentation of the state budget execution report could be improved because the report does not indicate the amount or purpose of money carried forward from the preceding accounting year to the current, neither does it identify the ministries to which such funds are assigned. Further, Note A31 to the report, which sets out the nationwide total of **funds carried forward from the preceding budgetary year** broken down by the intended purpose, provides no explanations either. Furthermore, there is no information as to why the money remained unused and was carried forward.

8. For instance, 550 million euros which remained unused in 2013 were carried forward to the 2014 budget - this accounts for 7.3% of the total expenditure in 2014. Thereby, 474 million euros were intended for operational expenses (incl. grants and 62 million for investments, but the report does not specify the recipient ministries or the respective amounts.

9. The 2014 State Budget Execution Report indicates that 502 million euros have been carried forward from 2014 to 2015 - this accounts for 6.6% of the total expenditure in 2014. The report does not say why the money remained unused and was carried forward to the next year. For about one quarter of this amount (121 million euros that mostly comprise expenses within the limit of 3%, investments and co-financing of foreign aid), there is detailed information available on the web site of the Ministry of Finance (incl. on recipient ministries and projects) concerning the planned use of the amounts carried forward to 2015. This practice is unprecedented and the NAO finds it to be a positive development which should be furthered and continued. However, there is still no information on the remainder of the amount (381 million euros - primarily received foreign aid).

10. The NAO considers this to be a substantial amount the intended purpose of which, broken down by the ministries, has been decided by the Riigikogu in the State Budget Act for the preceding year. However, there is no relevant information on the use of this amount in the state budget execution report. Further, the analysis and disclosure of amounts carried forward is essential for the Riigikogu in adopting the next year's budget. Therefore, the state budget execution report should disclose information on the reasons for the carry-forward.

11. The NAO made the relevant recommendation in the previous year's audit report, and to some degree the Ministry of Finance has taken this into account in the preparation of budget documents.

Financing of ministries

12. In addition to the aforesaid shortcomings, the amount intended for financing the core activities of each ministry as set out in annual State Budget Act is not complete.

13. For instance, the expenditure on the core activities of the Ministry of the Environment and its agencies are annually financed from the Environment Programme through the foundation Environmental Investment Centre (EIC). In other words, all of the money necessary for

environment-related activities within the Ministry's government area is not envisaged as expenditure in the Ministry's budget. Such financing scheme entails an unnecessary administrative burden, because in order to receive funds through the EIC, the Ministry and its agencies must prepare project applications, which the EIC then reviews and the Ministry's committee evaluates. Thereafter, the EIC's Supervisory Board will approve the applications. Later, the beneficiaries must report on the use of support and the EIC will then inspect these reports.

14. In 2014, the core activities of the Ministry of the Environment and its agencies were financed in the amount of 8.8 million euros whereby 85 projects were granted funding through the EIC. This practice has been implemented for years. The NAO finds it unjustified to continue the non-transparent financing of commitments of the Ministry of the Environment and its agencies by means of project-based contracts with the EIC which is a practice that increases the administrative burden.

15. In the interests of transparency of the state budget, the National Audit Office disapproves of such financing of the Ministry's core activities, because the money needed for said activities is not recognised in the state budget as the Ministry's operational expenditure, and there is no comprehensive overview of the amount the Ministry needs from the state budget for its activities. Plus, this practice increases the administrative burden.

16. Yet again, the NAO detected an important fundamental difference between the annual accounts of the Ministry of the Environment and the budget execution report. To be specific, the environmental charges are supposed to be credited to budget of the Ministry of Finance instead of the budget of the Ministry of the Environment. Hence, these charges are included in the budget execution report of the Ministry of Finance. However, these charges have been accounted for in the accounts of the Ministry of the Environment. Consequently, the revenue reflected in the annual accounts and the budget execution report of the Ministry of the Environment are not comparable. In 2014, the collected environmental charges amounted to 98.7 million euros.

17. The NAO is still of the opinion that the same state agency must be treated as the performer of an economic transaction in both the annual accounts and the budget execution report. In this case, it would be appropriate to plan the environmental charges as revenue of the Ministry of the Environment, because it is responsible for the planning, imposition, verification and accounting of revenue from environmental charges.

18. NAO recommendations to the Minister of Finance and the Minister of Public Administration:

- outline, in the consolidated annual report of the state, justifications for carrying forward significant amounts from the accounting year to the following year, and include a reference to the location of more detailed information;
- disclose, on the web site of the Ministry of Finance, complete information on the amounts carried forward from the preceding budgetary year to the next;

- disclose, in a separate column of or notes to the state budget execution report, the funds carried forward from the preceding financial year to the accounting year, broken down by the ministries - similarly to funds carried forward to the following year;
- plan, on uniform basis and in full amount, the funds of all ministries necessary for the performance of statutory functions within their respective budgets;
- recognise the environmental charges in the budget and the accounts of the Ministry of the Environment, because it, and not the Ministry of Finance, is responsible for managing these charges.

Response of the Minister of Finance and the Minister of Public Administration: We agree that providing a more detailed justification for carrying funds forward increases the transparency of using the money. The balances of revenue accounts carried forward comprise mostly foreign aid which is received from the donors as prepayments in accordance with the conditions established by them. The specific use of EU funds is not known at the time of transferring prepayments to the Ministry of Finance. In turn, the Ministry of Finance transfers to the intermediate bodies a large prepayment which is distributed between many individual projects. Including such individual projects in the notes to the annual report of the state would add too much detailed information. In the report for 2014, as opposed to previous years, we provided more detailed explanations on the funds carried forward, but we undertake to re-examine the possibility of making the explanations even more detailed when drafting the report for 2015.

Further, we agree that the state budget execution report could be made even more detailed for the reader. However, we have to admit that the page size sets its limits and adding another column where a large number of rows would remain empty might not be the best solution. In the future, we will prepare a summary table broken down by the government areas of ministries, annex it to the state budget execution report, and include references to more detailed information. Furthermore, we point out that the analysts in the State Budget Department use the analysis of the expenses incurred in the final months of the year and the funds carried forward to prepare the next year's budget and review the ministries' requests for additional funding, and that this issue is addressed at the meetings of secretaries general and during the budget negotiations.

In connection with the developments in the financial management system (accrual-based state budget from 2017, and activity-based from 2020), we intend to harmonise the principles of recognising transactions to eliminate the current differences between the accounting principles used in budgeting and accounting. Harmonisation requires the restructuring of guidelines and the counselling of contributors to the management of public finances during the transition period.

For cash-based budgeting we rely on the rule that revenue is recognised in the budget of the government area which receives the money. The responsibility for the collection of environmental charges is divided on the basis of a cooperation agreement between the government area of the

Ministry of the Environment (imposition of charges) and the government area of the Ministry of Finance (collection of charges). Hence, the Ministry of Finance is responsible for collecting the environmental charges.

Use of budget funds

There are less and less irregularities in budget planning and implementation

19. The NAO finds that budget planning and implementation in the ministries and their agencies is generally well planned and there are less and less irregularities in using the funds. The NAO ascertained that some state agencies had incorrectly determined the economic substance of transactions and made investments from the funds designed for management expenses, and the other way round.

20. The NAO detected highest number of irregularities in the Ministry of Culture and its agencies:

- in four cases, management costs totalling 393,386 euros were paid from the funds intended for investments in the government area, and in six cases, a total of 385,271 euros was paid for investments on the account of funds earmarked for management costs;
- in six cases, subsidies amounting to 106,373 euros were paid from the budget lines intended for investments and management costs.

21. Also, the Government Office has planned and effected payments from the wrong budget lines:

- The Government Office has, on the account of its management costs, granted 253,435 euros to several state agencies towards expenses related to EU presidency, labour expenses of new ministers appointed upon cabinet reshuffle and the like, which, according to the economic substance of such transactions, should have been planned and effected as **transfers**. Since no money was planned in the budget for awarding transfers, the Office made use of the funds intended for management costs and granting of support.
- The Government Office has granted its cooperation partners a total of 106,520 euros for organising various events. These grants were paid from the budget intended for the Office's management costs in violation of the State Budget Act because the economic substance of these transactions is the granting of support.

22. Similarly to the Government Office, the Ministry of Economic Affairs and Communications (MEAC) granted funds to other state agencies in the form of support instead of transfers as would have been proper. According to the budget execution report of the MEAC, the Information System Authority has granted a total of 1.04 million euros as support to various ministries and agencies for making preparations for the population census. According to the State Budget Act, one state agency may grant funds to another only in the form of transfers and not as support.

Did you know that

recognising transactions as transfers allows eliminating these amounts whilst drafting the consolidated report on state budget implementation in order to avoid double recording of the same money in the said report.

Transfer – in the state budget and its implementation report, transfers are transactions where an agency within one government area grants support to an agency within another government area so that the recipient could make use of it and the donor expects no goods or services in return.

23. The NAO believes that the main reason behind the irregularities in using budget funds is that the economic substance of transactions has not been adequately analysed before planning funds in the budget and effecting payments. Due to incorrect budget planning and effecting payments from the wrong budget line, the budget and its implementation as recognised in the budget execution report are inaccurate and fail to provide a realistic overview of effecting expenditure. If the state budget execution report fails to recognise the transfers between state agencies, it will be impossible to eliminate in that report all the revenue and expenditure subject to consolidation.

24. In its audits, the NAO has emphasised that if there arises a need during the financial year for the expenditure to be used differently from what has been planned, a motion to amend the budget should be filed before conducting the transactions. The State Budget Act provides for the possibility of reallocating expenditure. The budget amendments made during the year ensure that the state budget execution report submitted to the Riigikogu provides accurate information on the economic activities of ministries.

Budgeting for lease contracts

Obligations assumed under financial lease contracts are not planned as financing transactions

25. The audits of the NAO have shown that state agencies lease vehicles, office furniture and computers for carrying out their core activities. The audits have revealed that the lease contracts entered into by the ministries and other state agencies contain several conditions which are in conflict with the State Budget Act or can be interpreted ambiguously.

26. Although the transactions have been correctly recognised in the accounts, i.e. as financial lease, no funds have been planned in the budget for such financing transactions - instead, these commitments have been honoured on the account of investments and management costs.

27. According to the State Budget Act, the state agencies may effect expenditure only if the budget provides for funds to this end. The State Budget Act stipulates that state agencies must not take loans, use capital lease and assume other long-term commitments unless these have been prescribed in the annual state budget. Hence, if there is a need to carry out financial lease transactions, these should be envisaged as financing transactions during the annual budgeting process.

28. Further, the NAO has detected that entities still enter into lease contracts where there is no clarity as to whether or not these represent financial lease transactions. The contract terms and conditions are such that the state agency cannot terminate these contracts prematurely without making all lease payments to the lessor and covering other expenses or, for instance, compensating the damages arising from the sale of property. The NAO finds that such terms and conditions could be disadvantageous regardless of whether the contracts in question concern financial or operating lease.

29. The NAO is of the opinion that establishment of common practices for entering into and budgeting for financial and operating lease contracts is important because differentiating between these transactions has an impact on the state's debt burden. For example, as at the end of 2104,

according to Note a30 D to the Consolidated Annual Report of the State, the operating lease commitments that cannot be terminated amounted to 375 million euros (unconsolidated data).

30. Last year, the NAO issued a recommendation to the Minister of Finance providing that during budget planning, the handling of lease transactions should be regulated so as to comply with the State Budget Act. The Minister agreed to take the recommendation into account in drafting the regulation which governs budget drafting. The Regulation adopted by the Minister of Finance on 9 January 2015 provides that financing transactions should be planned so that the financial lease contracts are classified according to the accounting regulations, and that the amount of long-term liabilities should be planned with due regard to all the new financial and operating lease contracts which are entered into. The Regulation contains no rules on contracts already entered into.

31. The NAO finds that the Ministry of Finance should continue its efforts to reorganise this field and for budgeting purposes recognise all contracts entailing financial expenses as financing transactions.

32. NAO recommendations to the Minister of Finance and the Minister of Public Administration:

- ensure that during the budget planning and negotiation process the agencies plan commitments arising from financial lease contracts as financing transactions;
- draw the attention of state agencies to the fact that the lease contracts to be entered into must not contain conditions which are disadvantageous for the state (e.g. in the case of termination, the imposition of a fine, compensation for loss from the sale of property, obligation to honour the remaining payments, and long term of advance notice of termination).

Response of the Minister of Finance and the Minister of Public Administration: We are aware that in some cases assets are intentionally acquired subject to an operating lease contract although it would be economically more efficient to use financial lease. This could be due to the simpler state budget rules applicable to operating lease. In addition to the provision of counselling, we intend to modify the relevant guidelines and address the topic at briefings. Further, we'll use our analysis capabilities to address this problem. As from 2015, we collect information on the long-term liabilities arising from the envisaged financial and operating lease contracts.

In most cases, the state agencies have respected the principles of the State Budget Act

33. When the NAO audited transactions in state assets, it focused primarily on the **prudent governance** of state assets which is one of the principles of governing state assets as set out in the State Assets Act.

34. There are plenty of transactions in state assets and the book value of assets in the possession of the ministries is huge (according to the unconsolidated data as of 31 December 2014, the value of assets amounted to 11.6 billion euros).

Use of assets

The NAO considers **governance to be prudent**, if state assets are purchases, obtained, managed, transferred or sold of expediently, purposefully, economically, efficiently, transparently and verifiably.

35. Like in the preceding years, the auditors from the NAO participated in the stocktaking organised by ministries on a random basis, examined the procedures governing stocktaking, and the documentation of stocktakes conducted at the end of 2014. Further, the auditors assessed the conformity of acquisition, use, transfer and write-off of state assets with the requirements set out in the State Assets Act, and reviewed the changes made in the contracts concerning state assets in 2014.

36. The NAO finds that the state accounting entities have, in all material respects, complied with the principles of the State Assets Act, except for the observations listed in sections 37 to 43.

Activities of state-established foundations

37. During the last year's audit, the NAO recommended that the Minister of Finance, in cooperation with the Minister of Justice, analyse which public services should be provided through foundations, and explain whether and to what extent the established foundations perform the said duties. The Minister of Finance agreed with the NAO and promised to carry out the analysis during the preparation of the 2014 consolidated report of government-invested companies, foundations and non-profit associations by including relevant agencies, and disclose the results of the analysis in the Green Paper of ownership policy of state agencies, developed pursuant to the action programme of the Government of the Republic. These documents are being developed.

Participation of state agencies in non-profit associations conflicts the State Assets Act

Exercise of membership rights in non-profit associations

38. According to the State Assets Act, the state's membership rights in non-profit associations (NPA) may be exercised by a Ministry designated by the Government of the Republic, or the Government Office.

39. Already in the last year's audit report, the NAO highlighted that the Government of the Republic has not authorised the Ministry of Agriculture to exercise membership rights in NPAs, although the Estonian Crop Research Institute has been a member of several NPAs for years. By now, the Government of the Republic has retroactively designated the Ministry of Agriculture to exercise the state's membership rights in NPAs.

40. The NAO recommended that the Minister of Finance identify the membership of agencies within the ministries' areas of government in NPAs and bring the exercise of membership rights in NPAs into conformity with the State Assets Act. The Minister of Finance agreed with the recommendation and undertook to ascertain participation in NPAs. According to the Ministry of Finance, the Ministry had already started to address these issues at the time this report was being prepared.

41. Nevertheless, the NAO concluded, as a result of audits carried out in 2014, that the agencies of the Ministry of Education and Research were members in 33 NPAs and the agencies of the Ministry of Culture in 5 NPAs, and that the ministries were unaware of that.

42. The Government of the Republic has not authorised the Ministry of Education and Research or the Ministry of Culture to exercise membership rights in any NPAs. Further, the ministries have neither assessed whether the participation of state agencies in NPAs serves the

state's interest nor determined the objectives of participation of their agencies in NPAs.

43. NAO recommendations to the Minister of Finance and the Minister of Public Administration :

- determine, in collaboration with the ministries governing the participating holdings, the objectives of participating in non-profit associations and whether participation in all such associations is justified.
- see to it that the exercise of membership rights in non-profit associations is brought into conformity with the State Assets Act;
- analyse whether participation in NPAs should be decided by the Government of the Republic, or alternatively, by the ministries themselves.

Response of the Minister of Finance and the Minister of Public Administration: We have started the regularisation of the membership of state agencies in NPAs. By 1 August, the exercisers of membership rights will submit reports to us. For NPAs where the state is not a statutory member we consolidate and review the justifications provided by the exercisers of membership rights as to their participation in the NPAs.

In order to align the exercise of membership rights with the State Assets Act, we request the termination of membership in NPAs for which the Ministry in question does not request the government to designate the entity exercising the membership rights.

The government should still remain the body who decides the state's membership in order to maintain uniform principles of participating in the activities of NPAs. This issue can be further addressed during the preparation of the White Paper on Participatory Policy-making.

As for compliance with the Public Procurement Act, the state agencies make less mistakes than they used to

Procurement activities of state agencies

44. According to the Public Procurement Register, the state agencies had a total of 2,074 completed or pending procurements in 2014 amounting to 634 million euros.

45. For years, the NAO has audited the procurement activities of state agencies, incl. compliance with the principles of the Public Procurement Act. In its earlier audits, the NAO has identified a number of cases where the procurement procedures and simplified procedures required by the law were not carried out, and detected irregularities in the documentation of procurement procedures, identified cases of failure to submit procurement reports, and found shortcomings in procurement rules and the preparation or updating of procurement plans.

46. In this year's audits, the NAO examined the internal controls in place for procurement procedures and audited the conformity of selected transactions with the Public Procurement Act and the internal rules of agencies. Among other things, the NAO inspected whether procurement procedures had been conducted for procurements exceeding the threshold

established for simplified procedures, and whether the correct type of procedure had been selected.

47. The audit results indicated that the number of cases where simplified or other procurement procedures were omitted has dropped. Likewise, the management of procurements has improved: the procurement rules have been put in place and they are sufficiently detailed, and procurement plans are mostly up to date and feature very few shortcomings. While in respect of audited acquisitions the agencies generally respected the Public Procurement Act, the NAO still identified several breaches.

48. The Ministry of Culture had the largest number of violations where the NAO detected a total of 22 cases where the Ministry or its agencies had failed to conduct the procurement procedure required by the Public Procurement Act. According to the Public Procurement Register, 40 procurements were carried out within the government area of the Ministry of Culture in 2014, meaning that the Ministry and its agencies have failed to carry out a procurement procedure in at least one third of the cases. For example, no procurement procedure was carried out for designing the exhibition on the ice-breaker Suur Tõll (total value 1.2 million euros excluding VAT). The NAO recommended that the Minister supervise the procurement activities of the Maritime Museum.¹

49. Further, there were violations in the Ministry of Defence, the Ministry of Education and Research, the Ministry of Agriculture and the Ministry of the Interior. Several procurement procedures, incl. simplified procedures had been omitted.

50. The NAO audited the agencies of the Ministry of Social Affairs and found that the Health Board had not complied with the requirements of the Public Procurement Act when outsourcing ambulance services. In 2014, the Health Board paid approximately 30 million euros to the operators of ambulance services. The NAO maintained its position despite the argument of the Minister of Social Affairs that there is no need to conduct a procurement procedure for outsourcing ambulance services. The Minister justified the omission of the procurement procedure by stating that the Health Board outsourced the ambulance services on the basis of the Health Services Organisation Act and the Administrative Co-operation Act.

51. The NAO did not detect violations of the Public Procurement Act within the government areas of the Ministry of Economic Affairs and Communications, the Ministry of Foreign Affairs, and the Ministry of Finance.

52. While the number of violations of the Public Procurement Act has dropped, these violations refer to weaknesses in the procurement planning, implementation and supervision system. The main shortcomings in the organisation of procurements are problems related to the varying interpretation and implementation of the act and insufficient experience or capability, especially in small agencies.

¹ For more details, see the NAO audit report "Accuracy of the Annual Accounts 2014 and the legality of the transactions of the Ministry of Culture".

Auditing of public procurements in companies, foundations and the State Forest Management Centre

53. The obligation to comply with the principles set out in the Public Procurement Act and conduct procurement procedures where necessary extends to all foundations controlled by the state, the profit-making state agency, and most of the state-owned companies. However, certified auditors have not audited compliance with the Public Procurement Act in all state-owned companies, foundations, or the profit-making state agency. The NAO has not conducted additional audit operations in these entities either. Therefore, general conclusions for state-owned companies and foundations, and the State Forest Management Centre cannot be drawn.

54. According to the Public Procurement Register, the state-owned companies, foundations and the profit-making state agency had a total of 1,071 completed or pending procurements in 2014 amounting to 269 million euros.

55. The certified auditors audited procurement activities in seven state-established foundations (Tartu University Hospital, Estonian Drama Theatre, Estonian Research Council, Archimedes, Tallinn Science Park Tehnopol, Enterprise Estonia and Information Technology Foundation for Education) and one state-owned company (Public Limited Company “Government Real Estate”).

56. Based on the audit, the certified auditor of the foundation Tartu University Hospital issued an observation concerning the omission of procurement procedures. The certified auditor of Enterprise Estonia did not issue any observations concerning the management of public procurements or compliance with the Public Procurement Act. For the other foundations, the auditors made observations concerning omitted simplified procedures, and internal controls. The report of the certified auditor of Government Real Estate has not reached the NAO by the time of drafting this report.

57. The NAO finds that the foundations should improve their internal controls for procurement management and align procurement management with the Public Procurement Act.

58. NAO recommendations to the Minister of Finance and the Minister of Public Administration:

- continue the counselling and educating of officers of state agencies;
- decide, whilst planning the measures for monitoring compliance with the Public Procurement Act, whether the amount of monitoring activities should be increased in the ministries' agencies where the NAO detected shortcomings;
- form an opinion as to whether the outsourcing of ambulance services by the Health Board is in conformity with the Public Procurement Act.

Response of the Minister of Finance and the Minister of Public Administration: We are constantly counselling and educating the contracting authorities and tenderers in the field of public procurement. We intend to provide more extensive training in 2016-2017 in connection

with the expected adoption of the new Public Procurement Act in April 2016.

The regular monitoring of public procurement is based on the annual ex-ante risk analysis. In the future, we will take into account the observations of the NAO when preparing risk analyses and work plans. This year, the regular monitoring focuses on the procurement activities of several ministries.

As for outsourcing ambulance services, the Ministry of Finance has already formed its opinion. Additionally, we note that pursuant to § 19 (1) of the Public Procurement Act, the contracting authority is not required to conduct a procurement procedure for the said services - instead, it must respect the general principles of managing public procurements and enter into a written procurement contract, if the value of services exceeds 10,000 euros. If the expected value of the contract exceeds 40,000 euros, the intention to enter into such contract must be made public on its web site or on the web site of the Public Procurement Register. As far as we know, the Health Board has made public on its web site its intention to enter into such contract and the terms and conditions of the call for tenders which means that the Public Procurement Act has not been violated.

Audits of the implementation of security measures of information systems have not been conducted in all cases

ISKE audits

Time limits for and frequency of audits of implementation of ISKE

- The first ISKE audit of a database with a high security level must be conducted by 1 March 2010 at the latest and repeated every two years.
- The first ISKE audit of a database with a medium security level must be conducted by 1 December 2010 at the latest and repeated every three years.
- The first ISKE audit of a database with a low security level must be conducted by 1 March 2011 at the latest and repeated every four years.

59. The NAO scrutinised the ministries and their agencies to determine whether the audits of the implementation of security measures of information systems (ISKE) affecting accounting (hereinafter "ISKE audits") have been carried out.

60. The obligation to implement and audit ISKE is governed by Regulation No. 252 of the Government of the Republic of 20 December 2007 on "System of security measures for information systems" which requires conducting an independent audit of the implementation of the system of security measures whereby the **time limit and frequency** of this audit depend on the security level assigned to the database. The objective of implementing ISKE is to ensure an adequate level of security for data processed in the information systems. The accuracy of financial information depends on this.

61. As a result of audits, the NAO made the following observations:

- Already during the audit of the annual accounts 2011 and the regularity of transactions, the NAO detected that the implementation of security measures of information systems in the Police and Border Guard Administration was not completed. Over the recent years, the said authority has addressed the issues of ISKE stocktake, preparation of a list of security measures and planning their implementation. According to the explanations provided to the NAO, the ISKE audit will be commissioned in 2015 at the latest, but that's yet to happen.
- The Ministry of Education and Research has failed to commission in due time the mandatory repeated ISKE audit to evaluate the Estonian Education Information System (EHIS) and

the Road Administration has failed to do the same with the traffic register (ARIS). In the ISKE implementation audit conducted for the ARIS information system in 2010, several material shortcomings were highlighted, but since the audit efforts have not been renewed, there is no information as to whether the shortcomings have been eliminated.

- Within the government area of the Ministry of the Environment, the ISKE audits of the following systems have been omitted: Recreational Fisheries Information System, Document Management System of the Ministry of the Environment, Environmental Register, National Register for Forest Resource Accounting, National Register of Earth Deposits, and Information System of the National Packaging Register.
- In the Ministry of Foreign Affairs, visas are processed in the Visa Register. This register is administered by the Ministry of the Interior which has not commissioned an ISKE audit to evaluate the information system.

62. ISKE audits have been conducted for information systems essential for state accountancy like the accounting software SAP, the Balance Sheet Records System and the State Treasury's information system e-Treasury. The audits did not reveal material shortcomings.

63. The ISKE audit provides an independent and professional assessment that the implemented security measures are sufficient for achieving and maintaining data security. The NAO has recommended that the ministries commission the required audits and the ministries have undertaken to do so.

Opinion on the accuracy of the Consolidated Annual Accounts of the State for 2014

The annual accounts of the state are accurate in all material respects.

Accuracy of annual accounts

64. **The annual accounts of the state, which indicate that the state's consolidated result for 2014 was 242.6 million euros and its total consolidated assets amounted to 15.45 billion euros as at 31/12/2014, give a true and fair view of the state's financial status, performance result and cash flow for the financial year ended in all material respects and in accordance with the Generally Accepted Accounting Principles of Estonia.**

65. In the opinion of the NAO, the accounting management in state agencies is solid and the quality of accounting is good. Agencies of the Ministry of Education and Research and the Ministry of Culture featured the highest number of irregularities.

66. Pursuant to the recommendation made by the NAO, the Ministry of Finance is planning to make changes in the reporting of national accounts. According to the planned changes, the substantive and formal requirements to the annual reports of ministries, constitutional institutions and the Government Office will be simplified, i.e. a complete annual report will no longer be prepared - instead, the basic financial statements

(balance sheet, income statement, state budget execution report) will be drawn up in the Balance Sheet Records System. This allows the ministries to save working time which otherwise would be spent on preparing hefty reports. The changes are to be effected in 2016 for the annual reports to be submitted for 2015.

67. The Ministry of Finance intends to complete the project of combining support services which began in January 2010 by 1 June 2017 at the latest. Thereby, the financial, personnel and payroll accounting of all ministries and their agencies and of the Government Office will be handled centrally by the State Shared Service Centre.

State forest is recognised without considering its specifics

68. Similarly to the previous years, the NAO disagrees with the Minister of the Environment and the Minister of Finance as regards the principles of accounting for state forests and maintains that these are inappropriate for state assets. Further, the NAO draws the attention of the users of the state's annual accounts to the fact that the applicable accounting methods used for state forests fail to provide sufficient information on the changes in the value of the forests over the years.

69. As at 31 December 2013, the book value of state forests was 776 million euros, whereas as at the end of 2014, it was 3.19 billion euros. The value of state forests has changed because the **discount rate** used for measuring fair value was reduced from 6% to 4%, and new forecasts covering a period of 10 years were used for accounting for expected sales revenue, forest management costs and felling quotas. The effect of the change in discount rate on the value of state forests amounted to 1.1 billion and the effect of the change in forecasts amounted to 1.3 billion euros.

70. According to the accounting methods applicable to state forests as of 2010, the balance sheet reflects only the value of forests intended for cutting, which is determined on the basis of the average sales price estimate for ten years - in other words, only discounted income from the sale of timber to be cut in the future has been recognised on the balance sheet. Since other forests are not recognised on the balance sheet, the balance sheet does not allow drawing conclusions on the condition and value of such forests.

71. In order to obtain an overview of the developments which occurred in state forests during the accounting year, one must read the State Forest Management Centre's annual report and its notes.

The accounting of the foundations controlled by the state and the state's public undertakings is generally at a good level

72. The annual accounts of the state contain the financial indicators of state-owned companies, foundations controlled by the state and the profit-making state agency. Certified auditors have audited the annual accounts of these entities, and the NAO has taken their opinion into account in expressing an opinion on the state's annual accounts.

73. The opinions of the certified auditors of the 2013 annual accounts of public undertakings and foundations are unqualified except for the

Drawing attention to the state forest accounting policies

Discount rate – a rate for converting future cash flows into current value. The discount rate is established in the General Rules of State Accountancy and it applies to all entities consolidated into the annual accounts of the state. § 48 (9) of the General Rules of State Accountancy provides that the annual discount rate is 4% (used to be 6% until 24 November 2014).

Opinions of certified auditors on the annual reports of companies and foundations controlled by the state and of the profit-making state agency

opinions provided on the annual accounts of AS Tallinna Sadam, AS Eesti Teed and the foundation Tallinn Science Park Tehnopol. The auditor did not provide an opinion on the annual accounts of AS Estonian Air. These circumstances did not affect the opinion of the NAO on the accuracy of the annual accounts of the state.

Assets value test is used to identify the need to lower the value of assets. During value test, the estimated sale price or instrumental value of the asset (so-called recoverable amount) is determined, and if both are smaller than the balance sheet value of the asset, the asset must be written down.

74. As at 31 December 2014, the annual accounts of AS Tallinna Sadam include assets related to cargo transport amounting to 44.3 million euros, and quays and territories for the transport of passengers amounting to 6.6 million euros - totalling 50.9 million euros. The auditor of the company issued an observation that in assessing the value of the said assets the corporate management relied on the cash flow estimate which, in the auditor's opinion, was not supported by the current cargo transport capacities, the revenue from passenger transport, or the information learned during the audit. The management of AS Tallinna Sadam **tested the value of assets** but did not consider it necessary to write down assets on that basis. The auditor has issued a similar observation in the preceding years.

75. Similarly to the two earlier years, the auditor of AS Estonian Air opted not to provide an opinion because the annual accounts had been drawn up based on the premise that the company is a going concern, but the auditor was not assured in that regard. The European Commission has initiated proceedings to inspect whether the loans given by the State of Estonia to Estonian Air in 2011-2013 constitute unauthorised state aid. As a result of the inspection the Commission may require premature repayment of loans. The State of Estonia has submitted an application to the Commission to receive authorisation for providing state aid to Estonian Air, but the proceedings are pending and the result is unknown. The management of Estonian Air has admitted that the company is unable to repay the loans prematurely. Hence, the ability of AS Estonian Air to continue its operations depends on whether the European Commission authorises the state aid granted to Estonian Air.

Conclusions of the NAO regarding the audited areas

76. The following table provides an overview of areas audited by the NAO and the main conclusions regarding the audited areas. The monetary value of policy areas as in the 2014 state budget execution report.

Table 1. Overview of audit areas and the corresponding opinions of the NAO

| Audited area | Monetary value in 2014, in EUR | Are the transactions correctly recognised in the accounts? | Have the principles of the listed legislation been respected in conducting transactions within the audit scope? |
|---|--------------------------------|--|---|
| Collection of revenue , incl. taxes and social security contributions, sale of goods and services, other revenue | 6.960 billion | Yes | Yes |
| Receipt of support , incl. mediation of support | 733 million | Yes | Yes |
| Granting of support , incl. mediation of support | 3.673 billion | Yes | Yes |

| | | | |
|---|---------------|-----|-----|
| Effecting of operating expenses and assumption of commitments, incl. labour and management costs, other operating expense, financial expenses, effecting of public procurement | 3.892 billion | Yes | Yes |
| Transactions in state assets , incl. investments, financing transactions, effecting of public procurement | 448 million | Yes | Yes |
| Depositing of public funds (interest revenue from bonds, deposits and loans, other financial revenue) | 11 million | Yes | Yes |
| Exercise of founder's rights in foundations, non-profit associations and profit-making agencies; state participation in legal persons governed by private law | 174 million | Yes | Yes |

77. A summary of audited areas and the NAO's opinions, broken down by ministries, is set out in Annex 1 hereto. The NAO has given detailed explanations of the omissions found and recommendations on how to avoid them in the audit reports and memos sent to state accounting entities. The financial audit reports are available on the website of the NAO.

/signed digitally/

Alar Karis
Auditor General

NAO recommendations to and replies from the Minister of Finance and the Minister of Public Administration

On the basis of the audit, the NAO made several recommendations to the Ministry of Finance. On 14 August 2015, the ministers sent their response to the recommendations made by the NAO.

Overall comments on the audit report

The NAO report provides a sound overview of the problems in the financial management of ministries, the Government Office and constitutional institutions, and serves as valuable input for harmonising and improving the management of public finances.

The following table, column "Replies from the ministers", provides our opinions as regards the government areas of the Minister of Finance and the Minister of Public Administration without distinguishing between the ministers.

We would like to thank the NAO for their efforts and look forward to continued constructive cooperation over the forthcoming accounting periods.

| NAO recommendations | Replies from the ministers |
|--|--|
| <p>Planning, implementing and reporting on the implementation of the state budget</p> <p>18. NAO recommendations to the Minister of Finance and the Minister of Public Administration:</p> <ul style="list-style-type: none"> ▪ outline, in the consolidated annual report of the state, justifications for carrying forward significant amounts from the accounting year to the following year, and include a reference to the location of more detailed information; ▪ disclose, on the web site of the Ministry of Finance, complete information on the amounts carried forward from the preceding budgetary year to the next; ▪ disclose, in a separate column of or notes to the state budget execution report, the funds carried forward from the preceding financial year to the accounting year, broken down by the ministries - similarly to funds carried forward to the following year; ▪ plan, on uniform basis and in full amount, the funds of all ministries necessary for the performance of statutory functions within their respective budgets; ▪ recognise the environmental charges in the budget and the accounts of the Ministry of the Environment, because it, and not the Ministry of Finance, is responsible for managing these charges. <p>(Paragraphs 6-17)</p> | <p>Response of the Minister of Finance and the Minister of Public Administration: We agree that providing a more detailed justification for carrying funds forward increases the transparency of using the money. The balances of revenue accounts carried forward comprise mostly foreign aid which is received from the donors as prepayments in accordance with the conditions established by them. The specific use of EU funds is not known at the time of transferring prepayments to the Ministry of Finance. In turn, the Ministry of Finance transfers to the intermediate bodies a large prepayment which is distributed between many individual projects. Including such individual projects in the notes to the annual report of the state would add too much detailed information. In the report for 2014, as opposed to previous years, we provided more detailed explanations on the funds carried forward, but we undertake to re-examine the possibility of making the explanations even more detailed when drafting the report for 2015.</p> <p>Further, we agree that the state budget execution report could be made even more detailed for the reader. However, we have to admit that the page size sets its limits and adding another column where a large number of rows would remain empty might not be the best solution. In the future, we will prepare a summary table broken down by the government areas of ministries, annex it to the state budget execution report, and include references to more detailed information. Furthermore, we point out that the analysts in the State Budget Department use the analysis of the expenses incurred in the final months of the year and the funds carried forward to prepare the next year's budget and review the ministries' requests for additional funding, and that this issue is addressed at the meetings of secretaries general and during the budget negotiations.</p> <p>In connection with the developments in the financial management system (accrual-based state budget from 2017, and activity-based from 2020), we intend to harmonise the principles of recognising transactions to eliminate the current differences between the accounting principles used in budgeting and accounting. Harmonisation requires the restructuring of guidelines and the counselling of contributors to the management of public finances during the transition period.</p> <p>For cash-based budgeting we rely on the rule that revenue is recognised in the budget of the government area which receives the money. The responsibility for the collection of environmental charges is divided on the basis of a cooperation agreement between the government area of the Ministry of the Environment (imposition of charges) and the government area of the Ministry of Finance (collection of charges). Hence, the Ministry of Finance is responsible for collecting the environmental charges.</p> |

| | |
|--|--|
| <p>Entry into lease contracts</p> <p>32. NAO recommendations to the Minister of Finance and the Minister of Public Administration:</p> <ul style="list-style-type: none"> ▪ ensure that during the budget planning and negotiation process the agencies plan commitments arising from financial lease contracts as financing transactions; ▪ draw the attention of state agencies to the fact that the lease contracts to be entered into must not contain conditions which are disadvantageous for the state (e.g. in the case of termination, the imposition of a fine, compensation for loss from the sale of property, obligation to honour the remaining payments, and long term of advance notice of termination). <p>(Paragraphs 25-31)</p> | <p>Response of the Minister of Finance and the Minister of Public Administration: We are aware that in some cases assets are intentionally acquired subject to an operating lease contract although it would be economically more efficient to use financial lease. This could be due to the simpler state budget rules applicable to operating lease. In addition to the provision of counselling, we intend to modify the relevant guidelines and address the topic at briefings. Further, we'll use our analysis capabilities to address this problem. As from 2015, we collect information on the long-term liabilities arising from the envisaged financial and operating lease contracts.</p> |
| <p>Exercise of membership rights in non-profit associations</p> <p>43. NAO recommendations to the Minister of Finance and the Minister of Public Administration:</p> <ul style="list-style-type: none"> ▪ determine, in collaboration with the ministries governing the participating holdings, the objectives of participating in non-profit associations and whether participation in all such associations is justified. ▪ see to it that the exercise of membership rights in non-profit associations is brought into conformity with the State Assets Act; ▪ analyse whether participation in NPAs should be decided by the Government of the Republic, or alternatively, by the ministries themselves. <p>(Paragraphs 38-42)</p> | <p>Response of the Minister of Finance and the Minister of Public Administration: We have started the regularisation of the membership of state agencies in NPAs. By 1 August, the exercisers of membership rights will submit reports to us. For NPAs where the state is not a statutory member we consolidate and review the justifications provided by the exercisers of membership rights as to their participation in the NPAs.</p> <p>In order to align the exercise of membership rights with the State Assets Act, we request the termination of membership in NPAs for which the Ministry in question does not request the government to designate the entity exercising the membership rights.</p> <p>The government should still remain the body who decides the state's membership in order to maintain uniform principles of participating in the activities of NPAs. This issue can be further addressed during the preparation of the White Paper on Participatory Policy-making.</p> |
| <p>Procurement activities of state agencies</p> <p>58. NAO recommendations to the Minister of Finance and the Minister of Public Administration:</p> <ul style="list-style-type: none"> ▪ continue the counselling and educating of officers of state agencies; ▪ decide, whilst planning the measures for monitoring compliance with the Public Procurement Act, whether the amount of monitoring activities should be increased in the ministries' agencies where the NAO detected shortcomings; ▪ form an opinion as to whether the outsourcing of ambulance services by the Health Board is in conformity with the Public Procurement Act. <p>(Paragraphs 44-57)</p> | <p>Response of the Minister of Finance and the Minister of Public Administration: We are constantly counselling and educating the contracting authorities and tenderers in the field of public procurement. We intend to provide more extensive training in 2016-2017 in connection with the expected adoption of the new Public Procurement Act in April 2016.</p> <p>The regular monitoring of public procurement is based on the annual ex-ante risk analysis. In the future, we will take into account the observations of the NAO when preparing risk analyses and work plans. This year, the regular monitoring focuses on the procurement activities of several ministries.</p> <p>As for outsourcing ambulance services, the Ministry of Finance has already formed its opinion. Additionally, we note that pursuant to § 19 (1) of the Public Procurement Act, the contracting authority is not required to conduct a procurement procedure for the said services - instead, it must respect the general principles of managing public procurements and enter into a written procurement contract, if the value of services exceeds 10,000 euros. If the expected value of the contract exceeds 40,000 euros, the intention to enter into such contract must be made public on its web site or on the web site of the Public Procurement Register. As far as we know, the Health Board has made public on its web site its intention to enter into such contract and the terms and conditions of the call for tenders which means that the Public Procurement Act has not been violated.</p> |

Overview of the Consolidated Annual Report

The Consolidated Annual Report of the State has been prepared pursuant to the State Budget Act and the Generally Accepted Accounting Principles of Estonia. The Consolidated Annual Report of the State comprises the state's annual accounts with the State Budget Execution Report (i.e. the state's consolidated and unconsolidated report), additional information about local governments, the public sector and the government sector, and the management report.

The accounts of 17 state accounting entities with the agencies in their areas of government, the State Forest Management Centre, 67 foundations under the control of the state and 31 companies are consolidated in the consolidated annual accounts of the state. Additional information is given about 215 local authorities, and the indicators of the foundations, non-profit organisations and subsidiaries under their control are also included. On top of the above, additional information about the government sector and public sector also contains legal entities in public law and entities under their direct or indirect control.

The Minister of Finance and the Minister of Public Administration are responsible for the preparation of the Consolidated Annual Report of the State and state accountancy is organised by the Financial Accounting Department of the State Shared Service Centre.

Description of audit

Justification and objective of audit

Pursuant to the State Budget Act, the National Audit Office must give its opinion on the accuracy of the Annual Accounts of the State and the regularity of transactions.

The objective of the audit is to express an opinion on the accuracy of the Consolidated Annual Accounts of the State for 2014 and the regularity of transactions. The Annual Accounts of the State contain the balance sheet of consolidated and unconsolidated assets and liabilities as at 31.12.2014, the consolidated and unconsolidated income statement, report on changes in net assets and cash flow statement for the financial year ended on 31.12.2014 a summary of the accounting policies and procedures used in preparing the annual accounts and other explanatory notes. The annual accounts contain the state budget execution report as a supplementary statement.

Principles of expressing an opinion

The opinion of the National Audit Office on the accuracy of the annual accounts of the state and the regularity of transactions means that

- the annual accounts are correct if they were prepared according to the Generally Accepted Accounting Principles and the Accounting Act, and disclose all of the significant information that gives a true and fair view of the state's financial status; and
- transactions are legal if performed in compliance with the State Budget Act, the 2014 State Budget Act and the 2014 State Budget Act Amendment Act.

Observations made in the report are findings which, due to the irrelevance of the amounts and the circumstances related to the appearance thereof, did not affect the opinion of the National Audit Office regarding the accuracy of the annual accounts and the regularity of transactions, but which could result in significant errors in the annual accounts or regularity of transactions under different conditions. An observation is deemed significant if being aware of it has an impact on the user of the annual accounts. Significance depends on the content of the observation and its monetary amount, and it is evaluated against the background of the surrounding conditions. The monetary value of significance is found as a

percentage of the assets calculated on the basis of the data given in the Consolidated Annual Accounts of the State.

Scope of audit

In the course of giving an opinion on the accuracy of the state's 2014 annual accounts, the National Audit Office evaluated the compliance of the annual accounts with the Generally Accepted Accounting Principles of Estonia. The Generally Accepted Accounting Principles are based on internationally recognised accounting policies and procedures (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 Principles Board as well as the General Rules of State Accountancy.

In order to express an opinion on the regularity of transactions, the NAO audited whether or not the transactions of state agencies were performed in accordance with the State Budget Act, the 2014 State Budget Act and the 2014 State Budget Act Amendment Act in all material respects. For this purpose the NAO focused on the expediency and transparency of state budget implementation by checking the expedient use of the investments and expenses of state agencies, their adherence to the budget and the justification of prepayments and expenses.

In addition to expressing an opinion on adherence to the State Budget Act, the NAO paid attention to adherence to the main principles of the Public Procurement Act and the State Assets Act when auditing regularity. For this purpose it checked, on a random basis, whether the procedure stipulated in the Public Procurement Act was followed in the case of acquisitions that exceeded the limit and whether the main principles of public procurements had been adhered to in respect of smaller acquisitions and evaluated whether assets had been used, preserved and transferred prudently.

Limitation of the scope

The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency. The annual accounts of companies, foundations and profit-making state agency were audited by certified auditors. The NAO considered the opinions of certified auditors when expressing its opinion of the annual accounts of the state. The certified auditors who provided their opinions on the annual accounts of foundations, companies and the profit-making state agency did not assess the regularity of their transactions (except for the certified auditors mentioned in paragraph 55 hereof) and the NAO has not performed any additional activities in this respect.

The NAO does not provided an opinion on the management report presented as part of the Consolidated Annual Report of the State. The numerical values in the management report originating directly from the annual accounts were checked.

The NAO did not carry out audit procedures to check additional information (annual accounts) about local authorities, the public sector or the government sector disclosed in the Consolidated Annual Report of the State.

Focus of audit

The NAO carried out the audit in accordance with INTOSAI (International Organisation of Supreme Audit Institutions) auditing standards which address the auditing of financial statements and the legality of transactions in the framework of an audit of financial statements. These standards require that an audit be planned and performed in a manner that allows the auditor to decide with sufficient assurance that the financial statements are free of any material misstatements and that transactions comply with the legislation specified in the description of the scope of the audit in all material respects.

During the audit, evidence was collected on the numerical values and disclosed information included in the annual accounts and on the regularity of transactions. To facilitate the planning of appropriate audit operations, the NAO considered the internal control system introduced for drawing up true and fair annual accounts and ensuring the legality of transactions without providing an opinion on the effectiveness of internal controls. Also, the audit looked into the relevance of accounting policies, the reasoning behind accounting estimates, and the overall presentation of the annual accounts.

The NAO is of the opinion that the audit provides a sufficient basis for expressing an opinion on the accuracy of the annual accounts and the regularity of transactions.

Time of completing the audit

The audit was completed in July 2015.

Audit team

Auditors of the Financial Audit Department took part in the audit, and it was managed by Gert Schultz, Senior Auditor of the Financial Audit Department in the capacity of Audit Manager, and Krista Zibo, Audit Manager.

Contact particulars

For further information on the audit, please contact the NAO Communication Service by phone: +372 640 0704 or +372 640 0777, or e-mail: riigikontroll@riigikontroll.ee

The electronic version of the audit report (pdf) is available on web site <http://www.riigikontroll.ee/>.

The summary of the audit report is available in English also.

The reference number of the audit report in the NAO records system is 2-1.8/15/60116/9.

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Earlier audits of the consolidated annual report of the state by the National Audit Office

12.08.2014 – **Report of the National Audit Office on the 2013 Consolidated Annual Report of the State**

15.08.2013 – **Report of the National Audit Office on the 2012 Consolidated Annual Report of the State**

27.08.2012 – **Report of the National Audit Office on the 2011 Consolidated Annual Report of the State**

15.08.2011 – **Report of the National Audit Office on the 2010 Consolidated Annual Report of the State**

31.08.2010 – **Report of the National Audit Office on the 2009 Consolidated Annual Report of the State**

All reports are available on the NAO web site www.riigikontroll.ee

Annex 1. Overview of audited areas broken down by the ministries and the Government Office, and the corresponding opinions of the NAO

| Audited area | | Collection of revenue, incl. taxes and social security contributions, sale of goods and services, other revenue | Receipt of support, incl. mediation of support | Granting of support, incl. mediation of support | Effecting of operating expenses and assumption of commitments, incl. labour and management costs, other operating expense, financial expenses, effecting of public procurement | Transactions in state assets, incl. investments, financing transactions, effecting of public procurement | Depositing of public funds (interest revenue from bonds, deposits and loans, opening balances for banking operations, other financial revenue) | Exercise of founder's rights in foundations, non-profit associations and profit-making agencies; state participation in legal persons governed by private law |
|--------------------------------------|----------------------------|---|--|---|--|--|--|---|
| Ministry of Education and - Research | Recognition in accounts | Yes | Yes | Yes | Yes | Observation was issued | | Yes |
| | Regularity of transactions | Yes | Yes | Yes | Observations were issued | Observations were issued | | Observations were issued |
| Ministry of Justice | Recognition in accounts | Yes | Yes | Yes | Yes | Yes | | |
| | Regularity of transactions | Yes | Yes | Yes | Observation was issued | Observations were issued | | |
| Ministry of Defence | Recognition in accounts | Yes | Yes | Yes | Yes | Yes | | |
| | Regularity of transactions | Yes | Yes | Yes | Observations were issued | Observations were issued | | |
| Ministry of the Environment | Recognition in accounts | Yes | Yes | Yes | Yes | Yes | | Observations were issued |
| | Regularity of transactions | Yes | Observation was issued | Yes | Observation was issued | Observations were issued | | Yes, the State Forest Management Centre has not been audited |
| Ministry of Culture | Recognition in accounts | Yes | Yes | Yes | Yes | Yes | | Yes |

| Audited area | | Collection of revenue, incl. taxes and social security contributions, sale of goods and services, other revenue | Receipt of support, incl. mediation of support | Granting of support, incl. mediation of support | Effecting of operating expenses and assumption of commitments, incl. labour and management costs, other operating expense, financial expenses, effecting of public procurement | Transactions in state assets, incl. investments, financing transactions, effecting of public procurement | Depositing of public funds (interest revenue from bonds, deposits and loans, opening balances for banking operations, other financial revenue) | Exercise of founder's rights in foundations, non-profit associations and profit-making agencies; state participation in legal persons governed by private law |
|--|-----------------------------------|--|---|--|---|---|---|--|
| | Regularity of transactions | Yes | Yes | An observation was issued concerning a violation of the State Budget Act | Observations were issued concerning violations of the State Budget Act and the Public Procurement Act | Observations were issued concerning violations of the State Budget Act and the Public Procurement Act | | Observations were issued |
| Ministry of Economic Affairs and Communications | Recognition in accounts | Yes | Yes | Yes | Yes | Observation was issued | | Yes |
| | Regularity of transactions | Yes | Yes | Observation was issued | Observations were issued | Yes | | Limitation of scope of audit for state-controlled companies and foundations |
| Ministry of Agriculture | Recognition in accounts | Yes | Yes | Yes | Yes | Observation was issued | | Yes |
| | Regularity of transactions | Yes | Yes | Yes | Observation was issued | Observations were issued | | Limitation of scope of audit for state-controlled companies and foundations |
| Ministry of Finance | Recognition in accounts | Yes | | Observation was issued | Yes | Yes | Yes | Yes |
| | Regularity of transactions | Yes | | Yes | Yes | Yes | Yes | Limitation of scope of audit for state-controlled companies and foundations |
| Ministry of the | Recognition in accounts | Yes | Yes | Yes | Yes | Yes | | Yes |

| Audited area | | Collection of revenue, incl. taxes and social security contributions, sale of goods and services, other revenue | Receipt of support, incl. mediation of support | Granting of support, incl. mediation of support | Effecting of operating expenses and assumption of commitments, incl. labour and management costs, other operating expense, financial expenses, effecting of public procurement | Transactions in state assets, incl. investments, financing transactions, effecting of public procurement | Depositing of public funds (interest revenue from bonds, deposits and loans, opening balances for banking operations, other financial revenue) | Exercise of founder's rights in foundations, non-profit associations and profit-making agencies; state participation in legal persons governed by private law |
|-----------------------------|----------------------------|---|--|--|--|--|--|---|
| Interior | Regularity of transactions | Yes | Yes | Yes | Observations were issued | Observations were issued | | Yes |
| Ministry of Social Affairs | Recognition in accounts | Yes | Yes | Yes | Yes | Observation was issued | | Yes |
| | Regularity of transactions | Yes | Yes | Yes | Observations were issued | Observations were issued | | Observation was issued |
| Ministry of Foreign Affairs | Recognition in accounts | Yes | | Yes | Yes | Yes | | |
| | Regularity of transactions | Yes | | Yes | Yes | Yes | | |
| Government Office | Recognition in accounts | | Yes | Qualification concerning the accuracy of annual report | Qualification concerning the accuracy of annual report | Yes | | |
| | Regularity of transactions | | Yes | Qualification concerning a violation of the State Budget Act | Qualification concerning a violation of the State Budget Act | Yes | | |