

# Accuracy of Annual Report 2012 and legality of transactions of the state



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## Summary of audit results

### What did we audit?

Every year the National Audit Office audits the state's annual accounts as well as the annual accounts of ministries, the Government Office and constitutional institutions. In addition to this the National Audit Office checks whether state agencies have performed their economic transactions in compliance with the most important legislation: the State Budget Acts, the State Assets Act and the Public Procurement Act. The National Audit Office also 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 found in transactions with state assets and public procurements are highlighted in the audit reports.

The obligation to audit the correctness of the annual accounts and the legality of the transactions of the state and the state accounting entity arises from the State Budget Act.

### What was the scope of our audit?

The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency in addition to the indicators of state accounting entities. The National Audit Office does not audit the annual accounts of these entities, but considers the opinion of certified auditors when expressing an opinion on the state's annual accounts.

The certified auditors who gave their opinions of the annual accounts of public undertakings, foundations and profit-making state agency did not assess the legality of transactions. The National Audit Office has not carried out any additional control procedures to assess the legality of transactions, which means that the scope of the audit is limited in this regard.

Nor did the National Audit Office carry out audit procedures to check additional information (annual accounts) about local authorities, the public sector and the government sector disclosed in the Consolidated Annual Report of the State.

### Why is this important to 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 on the account of this revenue.

The revenue collected by the state in 2012 amounted to 6.4 billion euros, which exceeded the revenue of 2011 by 501 million euros. The expenditure incurred by the state amounted to 6.5 billion euros, which exceeded the expenditure of 2011 by 306 million euros. The increase in revenue resulted mainly from the increase in taxes collected and expenditure mainly increased on the account of social benefits and the growth in payments made by the state into mandatory funded pensions. In 2012 expenditure exceeded revenue by 87.2 million euros. The deficit was mainly financed from loans.

According to the consolidated annual accounts of the state, the assets of the state as of 31 December 2012 amounted to 11.7 billion euros and the majority of the assets are fixed assets. Compared to the previous period the value of assets has increased by 1 billion euros, mainly on the account of tangible fixed assets and an increase in receivables and prepayments. As at 31 December 2012 the state's liabilities totalled 5 billion euros – an increase of 0.9 billion euros compared to the previous period. Long-term liabilities comprise the majority of liabilities and the increase in them was caused by the growth of long-term loans payable.

### What did we find and conclude based on the audit?

**The 2012 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.**

**Although the opinion of the National Audit Office about the state's annual accounts is unqualified, we emphasise the fact that the accounting policies used to recognise the value of state forest are not suitable for state assets.** According to the method established with the General Rules of State Accountancy the book value of state forest is only found via the value of the forest planned to be cut, and the actual value of the state asset and the changes occurring in the asset are not considered.

**The National Audit Office believes that the state's most significant economic transactions were performed in accordance with the State Budget Act, the 2012 State Budget Act and its amendment act. This means that the National Audit Office did not find any significant errors in the implementation of the State Budget Acts.** At the same time the National Audit Office found omissions in the acquisition of state assets and the organisation of their use.

The main observations of the National Audit Office are the following:

- **Similar to previous years, understanding the State Budget Execution Report remains a problem.** Namely, the manner of presentation of the report and the amendments made to the structure of the annual State Budget Act make it impossible to understand. However, budget planning and use in ministries has improved.
- **Although the requirements of the Public Procurement Act have been adhered to in the acquisition of assets, the auditors found several omissions:** some public procurements had not been carried out; public procurements were not documented as required; the required information was not always published in the Public Procurement Register or the presented information was misleading

and/or given too late; and there were no procurement procedures or they were inadequate.

- **The principles of the State Assets Act – to increase profit and avoid causing losses to the state – had not always been adhered to in the use of state assets.** Omissions were found in contracts entered into for the use of quarries, granting use of residential premises and granting a loan to Estonian Air.
- **The state has to keep in mind that transferring state assets to Riigi Kinnisvara AS will cause a considerable increase in rent expenses, which will increase the burden on the state budget. At the same time it is unclear where the funds required to cover the increase in rent prices will be found.** It is also impossible for the Ministry of Finance to directly influence pricing in a public undertaking, because the goal of the public undertaking is to make profit. This is why it is difficult for the state to manage changes in rent expenses in the state budget.
- **The volume of the reserves managed by the State Treasury increased in 2012.** Compared to 2011 the total value of the reserves increased by 515 million euros to 1.45 billion euros by the end of 2012. The state's cash reserve increased most, by 501 million euros, mainly resulting from the fact that the reserves of the Health Insurance Fund and the Unemployment Insurance were added to the state's cash reserves. The stabilisation reserve increased by 14.1 million euros in 2012.
- **The organisation of accounting improved in most ministries and their areas of government.** This also applies to the areas of government of the ministries where the National Audit Office found significant omissions in the previous year, which were mostly associated with the centralisation of accounting. The National Audit Office finds that the centralisation of accounting and the introduction of single accounting software have evened out the level of accounting.

### What did we recommend as a result of the audit?

#### Important recommendations of the National Audit Office to the Minister of Finance:

- Continue streamlining the principles of budgeting to guarantee transparency and clarity by eliminating the omissions pointed out in this and previous reports.
- Explain in the Explanatory Memorandum of the 2014 State Budget and in the State Budget Strategy to be submitted to the Riigikogu the length of time over which the increase in rent and lease expenses will be financed in the state budget and the activities of RKAS in agreeing on rent and lease terms with the state will be managed.
- Develop and establish new accounting policies for state forest, which proceed from the nature of state forest and the asset as a whole.
- Regularly assess the achievement of support service centralisation goals and the quality of the service, and organise an assessment of the impact of the activities of the State Shared Service Centre.

**Response of the Minister of Finance:** The Minister promised to continue to pursue activities designed to make the budget and its execution report more transparent and to monitor the implementation of the action plan of the State Shared Service Centre. The minister wrote in his response that he is planning to give explanations about the rent prices of real estate in the course of the budgetary process. The Minister of Finance maintained a different opinion on amending state forest accounting policies.

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## Opinion on the legality of transactions in 2012

### No significant errors were found in the implementation of the State Budget Act

#### Legality of transactions

1. According to the state's budget execution report, the budgetary revenue of the state in 2012 amounted to 6.4 billion euros and incurred expenditure totalled 6.5 billion euros. The National Audit Office is of the opinion that the state's most significant economic transactions have been carried out in compliance with the State Budget Act, the 2012 State Budget Act and its amendment act.

#### Limitation of scope of audit

2. The certified auditors who gave an opinion of the annual accounts of public undertakings, foundations controlled by the state and profit-making state agency have not assessed the legality of transactions, because the professional level of a certified public auditor, which is necessary for auditing the legality of transactions in the public sector, could only be acquired from the second half of 2012. The National Audit Office has not carried out any additional control procedures to assess the legality of transactions, which means that the scope of the audit is limited in this regard.

3. In addition to expressing an opinion on adherence to the State Budget Act, the National Audit Office paid attention to adherence to the main principles of the Public Procurement Act and the State Assets Act when auditing legality. The National Audit Office does not express an opinion on adherence with these laws and only presents the observations it made within the course of the audits.

### The manner of presentation of the State Budget Execution Report makes it impossible to understand

#### State Budget Execution Report

**Cash-based accounting** – recognition of economic transactions only when payment is received or made.

4. One of the main reports submitted as a part of the state's annual report is the State Budget Execution Report (hereinafter also the SBER) which contains the budgetary revenue, expenditure and financing transactions of state agencies (except the State Forest Management Centre). The SBER is prepared on the basis of the State Treasury's data on a **cash basis**. The requirement to prepare and submit the SBER arises from the Accounting Act, pursuant to which the SBER is prepared (at least to the extent set out in the state budget) for each item of the budget classification in force at the time of the adoption of the state budget.

5. According to International Public Sector Accounting Standard IPSAS 24 'Presentation of Budget Information in Financial Statements', the budget adopted by the parliament, the final budget and the data of actual execution of the budget must be presented in a manner that is comparable to the adopted budget. The level of detail of the budget act must thereby be assessed and, if necessary, the information must be submitted more concisely than in the act in order to facilitate reading. The reasons for any significant differences in the planned budget and the actual budget must also be explained. The purpose of submitting the information is to increase the transparency of the financial statements of the public sector.

## State budget and state Budget Execution Report are not fully comparable

6. Since 2009 the National Audit Office has drawn the attention of the Minister of Finance to the manner of presentation of the state Budget Execution Report submitted as part of the Annual Report of the state, which differs from the State Budget Act adopted for the fiscal year by the Riigikogu (SBER structure vs. structure of law).

7. As the principles of state budget drafting, the execution of state budget payments and the preparation of accounting reports are different, the State Budget Execution Report is presented in a manner that differs from the law. For example, not all revenue and expenditure is planned in the annual State Budget Act; expenses are incurred on the account of subsidies and revenue generated by economic activities according to actual receipt of revenue; estimated expenses are planned in the budget in approximate amounts; and the expenses transferred from the previous year to the next, money allocated from reserves and income directed to reserves are missing from the budget. However, the actual revenue and expenditure of the fiscal year are considered in preparation of the SBER. The amendments made to the 2013 State Budget Act and the recently prepared new Draft State Budget Act do not reduce the differences in the aforementioned manner of presentation either.

8. The National Audit Office is of the opinion that the large amount of expenditure transferred to the next year (430.9 million euros in 2012) suggests problems in budgetary planning and makes the Budget Execution Report non-transparent, because the transferred expenditure has not been indicated in a separate column and it is unclear how much of this money was spent in the financial year and how much remains. The majority of the expenditure to be transferred comprises amounts allocated for investments and benefits. When the need to transfer expenditure arises, the reasons are usually delays in investments and completion of foreign projects by the planned deadlines. This in turn suggests that there is an inability to consider actual possibilities (which are required for the successful completion of projects) in planning. This is not a problem that emerged in 2012, because large amounts of expenditure have been transferred to the next fiscal year in previous years as well.

9. In the 2012 State Budget Act, the receipt of budgetary revenue is predominantly planned in the budget of the persons who collect the revenue pursuant to law, but in the SBER some revenue has been transferred to the entities in whose bank account it is received.

- Similar to the 2011 State Budget Execution Report, the revenue generated by environmental charges in 2012 is planned in the budget of the Ministry of the Environment pursuant to the budget act, but in the State Budget Execution Report it is shown as revenue of the Ministry of Finance, because the money (56.8 million euros) has been paid into the revenue accounts of the Tax and Customs Board on the basis of an agreement entered into between the Environmental Board and the Tax and Customs Board. The 2013 State Budget Act states that environmental charges will form revenue in the budget of the Ministry of Finance.

The National Audit Office feels that such recognition of environmental charges is not justified, as planning and determining the revenue earned from environmental charges,

### Did you know that

receipts in the state budget and payouts from the state budget are made via current accounts owned by the Ministry of Finance. The current accounts opened by the Ministry of Foreign Affairs for embassies in other countries are an exception.

checking their correctness and accounting for them are tasks of the Ministry of the Environment. The Ministry of the Environment confirmed that dealing with environmental charges will remain one of its tasks irrespective of how the budget is drafted.

- The situation with the budget of the Ministry of Foreign Affairs is similar: the ministry collects and recognises in its budget and the Budget Execution Report the state fees collected for passports issued in foreign embassies. In essence, this is an activity of the Police and Border Guard Board, so the revenue it generates should be recognised in the budget and budget implementation of the Ministry of the Interior.

10. The National Audit Office is of the opinion that the duties assigned to the ministry by law, the money allocated for their performance and the revenue earned as a result of operations must be considered in the preparation of the budget execution report. This means that revenue must be recognised in the budget and the budget execution report of the area of government of the particular ministry that is obliged to collect certain revenue by law and that prescribes the expenses required for the collection of such revenue. It must therefore be recognised in the budget and report of the ministry that is responsible for the planning, controlling and receipt of the revenue.

11. This is why it is impossible to compare the transactions recognised in the annual accounts and the budget execution report of the ministry, because not all of the expenditure recognised in the ministry's annual accounts is recognised in the budget execution report and vice versa. The National Audit Office is of the opinion that the same entity must be treated as the performer of an economic transaction in both the annual accounts and the budget execution report. The only difference can emerge as a result of the implementation of cash-basis and accrual-basis principles.

### **The amendments made to the structure of the 2013 State Budget Act do not eliminate the shortcomings in the principles of preparation of the State Budget Execution Report**

#### **2013 budget structure**

12. The National Audit Office noted in the Report on Accuracy of Annual Report 2011 and Legality of Transactions of the State that the annual state budget adopted by the Riigikogu and the State Budget Execution Report cannot be compared, because the principles on which the report is prepared differ from the principles of budgeting. The National Audit Office advised the Ministry of Finance to streamline the budgeting principles and the structure of the annual state budget act, update the technical solutions of monitoring budget execution and set the presentation of a consolidated budget execution report as the goal.

13. The Ministry of Finance amended the structure of the 2013 State Budget Act and the amendment was generally based on the structure of the State Budget Execution Report used for several years.

- It is good that the budget is no longer given in both the consolidated and unconsolidated format in the budget act: the

budgets of the areas of government of ministries are given in unconsolidated format and the total budget of the state is given in consolidated format.

- Transferable taxes (i.e. the revenue that an agency collects but does not use in its own activities and transfers to other agencies) are distinguished better than before.
- The division of revenue and expenditure is no longer highlighted by the source of financing: codes are used to mark the sources. However, this means that the State Budget Act is even less transparent and the reader must know the budget classification codes in order to understand it. This solution decreases the readability of the state budget.

### Did you know that

since the 2011 state budget, the recognition of expenditure in the state budget is no longer as detailed as before, but most of the expenditure was distinguished by the specific activities and tasks for which they had been allocated.

14. Also, the level of detail of the expenditure given in the State Budget Act has been reduced by the amendment: in the state budget acts for earlier years, expenditure was distinguished by purpose (appropriation for child welfare, appropriation for religious associations etc. being distinguished in the budget for 2010), but this has gradually been abandoned in recent years and the separate purpose was only noted for a few expenses in the 2012 state budget.

15. Although this manner of presentation allows the Government of the Republic to react flexibly if the need to use budget money changes, it also curbs the possibilities of the Riigikogu to inspect the preparation and implementation of the budget.

**16. Suggestion made by the National Audit Office to the Minister of Finance:** continue streamlining the principles of budgeting to guarantee transparency and clarity by eliminating the omissions highlighted in this and previous reports, including

- review the manner of presentation of the State Budget Execution Report, add a separate column about the budget of the expenditure transferred from the previous year to the report and highlight the amount of the expenses incurred for the transferred money next to the actual implementation of the budget;
- plan the revenue and expenditure in the budget for the ministries to whose main activities they relate and report on the implementation of this by the same ministry.

**Response of the Minister of Finance:** Similar to the National Audit Office we also consider it important to continue improving the transparency and comprehensibility of the budget and its implementation report (which is why the budget act is being presented in amended format starting from 2013).

The initial and final budgets are presented in the Budget Execution Report. The budget of the expenditure transferred from the previous year is also included in the final report. If we submitted an additional column just for the budgets transferred from the previous year, it would raise the question as to why other budget adjustments which change the initial budget in comparison to the final one are not separately highlighted (e.g. supplementary budget). Such an additional column would make the

Budget Execution Report longer, but the additional information it provided would be limited. Also, the budget of the expenditure transferred from the previous year can be found in the report for the previous year. This is why we do not consider the separate presentation of the budget transferred from the previous year to be necessary.

The budget of the transferred expenditure is used up first of all, which is why we do not consider it necessary to distinguish the actual use of the budget of transferred expenditure. The budget transferred from the previous year was opened in the State Treasury just a couple of years ago (so-called source code 99), which is why it had to be separately used. This created additional technical work for accountants, but provided no added value in guaranteeing budget discipline. This is why the requirement to use the budget transferred from the previous year separately was abandoned last year.

The recommendations of the National Audit Office have been largely considered since 2013 due to the amended structure of the State Budget Act. One of the goals of amending the structure of the State Budget Act was to plan a cash-based budget in such a manner that it would comply with the actual movement of money between agencies. Otherwise, guaranteeing control over the implementation of a cash-based budget would be impossible.

### Budget planning in ministries has improved

17. The National Audit Office is of the opinion that the planning and use of the budget in ministries and the agencies in their areas of government has improved. Similar to the audits carried out in previous years, the results of the financial audits performed by the National Audit Office for 2012 also indicated that the principles of the State Budget Act are still being erred against when long-term lease contracts are entered into.

18. The State Budget Act prohibits state agencies from taking out loans, using **capital leases** and entering into other **long-term liabilities**. This is only permitted if prescribed in the annual state budget. If a state agency wishes to perform such transactions and enter into contracts, the payments to be made within the scope of long-term contracts must be planned as **financing transactions when the annual budget is drafted**. Otherwise, the performance of such transactions is in contravention of the State Budget Act.

19. The audit of the National Audit Office revealed that in recent years, entering into long-term lease contracts that cannot be terminated has become widespread, which means that state agencies cannot terminate the contracts early without having to pay all of the outstanding lease payments, the residual value of the leased object upon the expiry of the lease contract and the financing costs to the lessor. The Unconsolidated Annual Report of the State (Note 30) indicates that the state's lease obligations that cannot be terminated total 296 million euros.

20. The National Audit Office finds that the annual payments that must be made under lease contracts that cannot be terminated must be included among financing transactions in budget drafting. These contracts may not be entered into, unless otherwise provided for in the State Budget Act. Since such contracts are not normally (i.e. according to past practice)

### Budget planning

**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. Ownership may but need not eventually transfer.

**Long-term payable** is a debt

- which emerged as a result of a past event,
- release from which is likely to require giving up resources in the future, and
- which will be repaid over a period that is longer than one year.

**Financing transaction** is a transaction aimed at covering the difference between state budget revenue and expenditure, which recognises changes in financial assets and liabilities. Financial assets are deposits, loans granted, securities purchased and other similar assets. Liabilities are loans taken, securities issued and other similar liabilities.

terminated early, it is important that the long-term obligations assumed with these contracts are clearly distinguished in the budget.

21. As the National Audit Office already wrote in its audit report for the last two years, the omissions in budgeting are probably caused by insufficient analysis in the planning stage and unclear budgeting (incl. budget amendment) principles.

22. The National Audit Office advised the Minister of Finance that the content of financing transactions must be specified in the annual directive on the terms and deadline for drafting the budgets of ministries. The National Audit Office also advised distinguishing the money required to service lease contracts that cannot be terminated in the budget, and to permit entry into such contracts only if money is allocated for this purpose in the budget. The Minister of Finance agreed with the proposals of the National Audit Office and promised to define the term 'lease contracts that cannot be terminated' in the guidelines on the use of the budget classification that will be prepared in 2012, and establish rules for planning funds in the state budget for these contracts from 2014. However, this has not been done: a new Draft State Budget Base Act has been prepared instead (see art. 23-28).

### **Amendment of the State Budget Base Act is expected to eliminate omissions in the previous act**

#### **New State Budget Base Act**

23. The Ministry of Finance is preparing the new Draft State Budget Base Act, i.e. the State Budget Act, whose goal according to the explanatory memorandum of the act is to create a legal basis and establish the principal requirements that guarantee the economic and financial sustainability of Estonia. The draft should establish the requirements for different budget fields and define the terms and principles of budgeting. By the time this report was prepared, the draft had been introduced to the Government of the Republic and sent on the approval round. The National Audit Office reviewed the draft submitted for approval on 3 July 2013.

24. The National Audit Office submitted its full opinion on the draft act on 9 July 2013. Irrespective of this we find that the following problems must be resolved as a result of the preparation of the new State Budget Base Act.

25. One of the most common errors detected by the National Audit Office during the annual financial audits is the assumption of long-term obligations with lease contracts which are not planned as financial transactions in budget drafting. Pursuant to the State Budget Act, state agencies are currently prohibited from entering into long-term obligations that last for more than one fiscal year if the relevant expense is not prescribed in the annual budget act.

26. The Draft State Budget Act, however, permits the use of capital leases if this is prescribed in the state budget. No rules are established in regard to other long-term obligations assumed with lease contracts (e.g. operating lease contracts that cannot be terminated). The National Audit Office is of the opinion that the updated regulation does not reduce potential future mistakes in the assumption of long-term obligations.

27. Also, a common problem in previous years has been the planning of expenditure incurred on the account of revenue earned from economic activities – the amount of this revenue is consistently underestimated in some ministries during budget planning. Failure to consider all of the revenue earned in budget drafting means that the relevant expenditure is also not considered and this creates fertile ground for the impractical use of the revenue earned. The 2012 State Budget Act states that government agencies have the right to use the money received from economic activities according to the actual receipt of the money and the planned economic content. If the amount of revenue received is planned in the Annual State Budget Act as being smaller than the actual amount, the amounts received in excess of the planned amount have no economic content. The Draft State Budget Act does not contain detailed regulation of the payment of expenditure from the revenue received from economic activities.

28. The National Audit Office hopes that the amendment of the State Budget Act will create the pre-requisites for a single budget planning framework which helps coordinate budget drafting and activity planning better.

### **There are omissions in the acquisition of assets and the organisation of their use**

#### **Acquisition and use of assets in ministries**

29. The auditors of the National Audit Office inspected the acquisition and transfer of assets in ministries and agencies in their areas of government, and reviewed contracts for granting use of state assets. Compliance with the Public Procurement Act was also inspected in addition to adherence to the State Assets Act. The observations made about compliance with the Public Procurement Act are given in articles 51-61 of this audit report.

30. Since 2001, constitutional institutions, the Government Office and ministries with agencies in their area of government have transferred large quantities of fixed assets required and not required for main activities to Riigi Kinnisvara AS, which has reduced the quantity of assets under management in the ministries. The observations made about the transfer of real property to RKAS are given in articles 40-50 of this audit report.

31. As a result of auditing the transactions carried out with assets, the auditors of the National Audit Office found omissions in the contracts entered into for the use of the Road Administration's quarries and for granting use of the residential premises of the Defence Forces.

- Pursuant to the regulation of the Government of the Republic<sup>1</sup> use of a registered immovable for mining mineral uses is granted by way of a lease, the establishment of a usufruct or the right of superficies. Analysis of the contracts selected as a result of the audit activities revealed that the Road Administration had also granted use of mines in a manner not permitted by said regulation, i.e. with authorisation contracts or contracts for sale of

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<sup>1</sup> Procedure for Granting a Registered Immovable Belonging to the State for Mining Mineral Resources

mined ore. It was also revealed that the terms and conditions required in the same regulation had not been included in all of the analysed contracts. For example, it had entered into a contract under which the Road Administration, not the user of the quarry, was obliged to recondition the quarry after the expiry of the contracts; and contracts where liability for failure to perform the contract or the Road Administration's right to amend the charges arising from the contract had not been defined. The Road Administration had also not exercised the right to amend the amount of the charge for granting use of a registered immovable for mining mineral resources, proceeding from the changed taxation rate. The National Audit Office is of the opinion that this is an infringement of the law, because contracts have been entered into that create obligations for the state that should not be created, and the profit the state could earn from granting use of the asset has not been increased either.

- The Defence Forces have apartments to guarantee temporary places of residence for servicemen dispatched to new locations. The Military Service Act and the Dwellings Act grant servicemen in active service and former servicemen who as at 1 July 2002 had served in the Defence Forces for 10 years the basis to use apartments belonging to the Defence Forces. However, in addition to servicemen in active service and former servicemen, the residential premises belonging to the Defence Forces are also used by people who have no legal basis for doing so: there were 79 such persons as at 31 December 2012. The audit revealed that the established rent was lower than the market conditions and that those who have no legal basis for using the apartments pay rent at the same rate. The Defence Forces explained that the rent price of apartments is determined according to the rent limits established in Regulation 464 of the Minister of Defence of 16 December 2010. The National Audit Office is of the opinion that renting apartments provided by the employer to those who have no legal right to such accommodation on conditions that are more favourable than the market conditions is not justified. This is a breach of the principles of the State Assets Act, because the profit that could be made from renting has not been increased in transactions with state assets.

32. In addition to the above, auditors from the National Audit Office participated in the stocktaking organised by ministries on a random basis. They reviewed the procedures that regulate stocktaking and the documents of the stocktaking organised at the end of 2012. As a result of this, the auditors found omissions in the established procedures (in the Ministry of Culture), the organisation of stocktakes (in the Ministry of Culture, the Ministry of Social Affairs and the Ministry of Defence) and documentation (in the Ministry of Social Affairs).

## Loan to AS Estonian Air

### Compliance with state asset management principles was not considered when a loan was given to Estonian Air

33. On 13 December 2012 the Government of the Republic issued an order containing a decision to allocate 8.3 million euros from the Government's ownership reform reserve fund to AS Estonian Air as a

loan for guaranteeing air service to hubs important to Estonia, thereby contributing to the development of business and the creation of the environment and conditions required therefor.

**34.** The first part of the loan (793,000 euros) was paid out on 20 December 2012. The remainder of the loan amount was paid out to the company in two parts: 3 million euros on 18 January 2013 and 4.507 million euros on 11 February 2013.

**35.** In addition to the 8.3 million euros, the Government of the Republic decided to lend AS Estonian Air 16.6 million euros with its order issued on 28 February 2013 and another 12.1 million euros with its order dated 2 May 2013. The first of these amounts was paid out on 5 March 2013, but the other amount had not been paid out by the time this report was prepared.

**36.** As at the balance sheet date (31 December 2012), the Ministry of Finance decided to recognise the amount of 793,000 euros paid out to AS Estonian Air as a loan in 2012 as a doubtful receivable based on the principle of conservative accounting. The reasons why the debt was declared doubtful are the following:

- The company is in financial difficulties and a restructuring plan is being prepared, which requires a large injection of money from the state.
- State aid approval by the European Commission is a pre-requisite for the restructuring plan, but the receipt of this approval is questionable. If approval is not received, the company must repay the loans to the state, which would bankrupt it.
- The company will probably be unable to repay the loan granted by the state when due using its own cash flow and therefore requires an increase of its share capital on the basis of the restructuring plan, which cannot be done until state aid approval is granted.
- Banks will not lend to the company.

**37.** The certified auditor of AS Estonian Air refused to express an opinion on the company's 2012 annual accounts, because it was impossible to obtain sufficiently relevant evidence to form an opinion. Namely, the auditor had no reassurance about the continuation of the company's operations, which was the basis for the preparation of the annual report.

**38.** The National Audit Office is of the opinion that recognising the loan as a doubtful debt in accounting is justified and correct. The ownership reform reserve fund is part of the state's reserves and it is therefore an asset of the state. The State Assets Act stipulates that state assets must be managed economically and that transactions which cause damage must be avoided.

**39.** The National Audit Office is of the opinion that the circumstances under which the loan was declared to be a doubtful debt were known before the additional loan was granted, which means that the principles of

the State Assets Act were not considered when further loans were granted from the ownership reform reserve fund of the Government of the Republic.

### **Transferring state assets to Riigi Kinnisvara AS increases the burden on the state budget**

#### **Analysis of impact of increase in rent prices**

40. Appointing Riigi Kinnisvara AS as the provider of property services to the state was discussed at a Cabinet meeting held on 18 February 2010. The managers of state assets were required to transfer the general-purpose built-up registered immovables under their management to RKAS on the basis of agreed lists by 30 June 2011, while special-purpose registered immovables had to be transferred by 31 December 2012. As suggested by the Minister of Finance, RKAS had to guarantee that the assets that remained in the use of state agencies would be managed within the scope of current budgetary funds and that the use of premises and the property portfolio would be optimised within two years of taking over the assets. The minister's requirement applied to general-purpose property until 31 December 2012 and it will apply to special purpose property until 31 December 2014, unless investment obligations are assumed in regard to the object of contract before that date.

41. A significant quantity of property required for the principal activities of ministries was transferred to RKAS in 2011 and 2012 and new lease contracts were entered into with RKAS. The state's rent expenses as a whole have not increased significantly, because on 18 February 2010 the Minister of Finance suggested at the Cabinet meeting that no rent would generally be paid to RKAS within two years of the transfer of property to RKAS and that only the direct costs related to the use of buildings (e.g. utilities) would be covered.

42. This means that the expenses of property maintenance did not increase significantly for ministries in the state budget during the period. From 2013 ministries will have to allocate money for a transfer to rent that corresponds to market conditions. If the transferred buildings are renovated, ministries will also have to consider the added capital component in their budgets once two years has passed from the transfer of property.

#### **Did you know that**

**The increase in the rent price payable to RKAS** is related to the circumstance that depreciation on the property that was not recognised in the rent price before as well as the other expenses that were directly or indirectly related to property management are now included in the price.

43. The state budget strategy for 2014-2017 was discussed at the Cabinet meeting in April this year. The materials of the Cabinet indicated that the rent expenses of ministries are growing considerably. Rent and lease payments comprise 38% of the management expenses of registered immovables, buildings and premises in the last three years (totalling 29.8 million euros in 2012), but this percentage will start growing in the coming years in relation to the assets transferred to RKAS. According to the forecast submitted by RKAS, the amount spent on rent will be 40.5 million euros in 2013; 59.8 million euros in 2014; 64.9 million euros in 2015; 69.2 million euros in 2016; and 79.2 million euros in 2017. This means that in the next four years, rent expenses will probably more than double. It was decided at the Cabinet meeting that the Government would discuss finding sources to cover the rent payable to RKAS following the completion of the summer economic forecast and that ministers would be expected to make proposals about finding additional sources of cover that had a long-lasting impact.

### Did you know that

optimising the need for premises is possible in the case of general-purpose properties (office premises etc.), but optimising the need for premises in the case of special-purpose properties (museums, prisons, rescue command etc.) is difficult if not impossible.

44. The ministries explained to the National Audit Office that the expenses associated with the use of the property they need for their principal activities are increasing, although they have given up assets that the state does not need for its principal activities, i.e. they have optimised their need for premises. For example:

- 102 of the objects transferred to RKAS by the Ministry of Social Affairs as at 31 December 2012 will be necessary in future (i.e. a lease contract for their use has been entered into with RKAS) while 175 of them are unnecessary. According to the ministry's forecast for 2014 the expenses related to the properties in its use will increase by *ca.* 10 million euros.
- The Ministry of Culture has entered into a lease contract with RKAS for the further use of 16 of the 21 objects it transferred and decided that it does not need the remaining 5 objects for its further activities. According to the ministry's forecast for 2014 the expenses related to the properties in its use will increase by *ca.* 3.3 million euros.

45. This means that despite the activities of the ministries in the optimisation of their premises and having given up the premises they do not need, both the ministries and the state as a whole must accept that rent expenses will grow significantly in the coming years. The state budget strategy approved in spring does not specify the sources from which the money to cover the increase in rent prices will be found. As RKAS is a public undertaking, it is impossible for the Ministry of Finance to influence its pricing to a significant extent or for the state to manage the changes in rent expenses in the state budget.

### Revaluation of asset transfer

46. According to the agreements made by the Cabinet, the ministries will transfer their properties to RKAS and the share capital of RKAS will be increased by the value of the properties by way of a non-monetary contribution. The transfer of assets really took off in 2011. The overview given to the supervisory board of RKAS in April 2013 indicated that 345 objects with 209,700 m<sup>2</sup> of net closed space were transferred to RKAS in 2012 alone, 75% of which is needed by the state for the provision of public services. The Ministry of Justice and the Ministry of Finance have transferred their assets to RKAS in full. The Ministry of the Interior had transferred 73% of its assets as at 31 December 2012. The Ministry of Culture has also started transferring its assets.

47. Riigi Kinnisvara AS has ordered expert valuation of the assets for the purposes of the non-monetary transfer of the registered immovables. The expert has not proceeded from the actual purpose for which the asset is used, even in cases where the transferor of the assets needs them for the provision of public services in future, but instead has valued it from the possible alternative purpose of use of the assets. In such cases the assets have been revalued as a result of the expert valuation report and recognised in the balance sheet of RKAS at the revalued amount. For example:

- The building of the Võru Rescue Command that was constructed in 2002 and designed for the Rescue Board, which in the opinion of the Ministry of the Interior will also be used as a rescue building in the future, has been revalued as an office, service and

warehouse building from the aspect of alternative use. As a result of this the book value of the building, which was 1.07 million euros, was revalued as 170,000 euros.

- The building located at Raua 2, Tallinn, which was built for the rescue service in 1938 and where the purpose of land use is national defence land, has been valued by the expert as an alternative office and warehouse building. The book value of the property in the opinion of the expert is therefore 850,000 euros instead of the former 2.13 million.
- Experts have valued museums from the aspect of alternative use as office, trade or service premises. For example, the Pärnu Museum, which was built as a museum in 1896 and reconstructed for EU funds in 2011, was valued from the aspect of alternative commercial use as an office, sales or conference centre. As a result of this the book value of the museum, which was 2.23 million euros, was revalued as 642,000 euros.
- The building of the Tartu Circuit Court, which was constructed as a courthouse in 2002 and which according to the plans of the Ministry of Justice will be used as a courthouse also in the future, was valued as a commercial and office building considering the purpose of use suggested by the expert. As a result of this the book value of the courthouse, which was 6.75 million euros, was revalued as 2.75 million euros.

48. As state assets are in many cases designed and built as special purpose assets, and as such assets do not have a market on the basis of which the market price could be found, revaluing the assets on the basis of the market price is not justified. Experts should proceed from the substantive opinions of ministries about the purpose for which the assets are used.

49. In the opinion of the National Audit Office, proceeding from alternative purposes of use is not justified in cases where the long-term plans of ministries indicate that the buildings will also be needed for the provision of public services in the future. If the purpose of use does not change, transferring the property cannot impact on its value, as its use for the provision of public services will continue.

#### **50. Recommendations of the National Audit Office to the Minister of Finance:**

- explain in the Explanatory Memorandum of the 2014 Draft State Budget and in the State Budget Strategy that will be submitted to the Riigikogu the length of time over which the increase in rent and lease expenses will be financed in the state budget and the activities of Riigi Kinnisvara AS in agreeing on rent and lease terms with the state will be managed.
- steer the activities of Riigi Kinnisvara AS in ordering property valuations from experts in such a manner that the substantive opinions of ministries regarding the intended use of the assets is considered as the basis of the valuations.

**Response of the Minister of Finance:** We would like to point out that the rent expenses of state agencies before the transfer of assets to Riigi Kinnisvara AS (RKAS) are incomparable with the rent expenses that emerge after the transfer. Depreciation and other direct and indirect property management expenses were not recognised in rent expenses before the transfer of assets to RKAS, which the National Audit Office also noted in the draft. This means that the figures presented in the report as well as the performance (“This means that in the next four years, rent expenses will probably more than double”) are based on incorrect assumptions and are therefore inadequate. We will submit the relevant explanations about the topic of rent prices in the explanatory memorandum of the draft and in the budget strategy.

Establishing a single set of rules for the state is one of the main tools for managing the expenses related to the properties of the state. This helps to rent premises in a manner that is transparent and comparable, and to efficiently analyse used premises for making necessary management decisions. We are monitoring and analysing the market to see whether the rent requested by RKAS complies with market conditions and plan to continue this activity in the future. This helps the state enter into thoroughly considered and practical lease contracts with RKAS.

**Comment by the National Audit Office.** The National Audit Office obtained the information that rent expenses will double from the materials submitted by the Ministry of Finance to the Cabinet session of the Government of the Republic.

### **The requirements of the Public Procurement Act have been observed in most state agencies and the state’s foundations and public undertakings**

51. Similar to the previous year the National Audit Office audited whether the Public Procurement Act had been adhered to in all ministries, constitutional institutions and the Government Office in respect of acquisitions made in 2012.

52. The National Audit Office audited the organisation of public procurement in all 84 public undertakings and foundations of the state in a separate audit. The period covered by the audit is 1 January 2011 to 31 May 2012.

53. In its audits the National Audit Office focussed on the internal control system that concerns the [public procurement procedure](#), and assessed whether the procurements in certain selected transactions complied with the Public Procurement Act and the internal work procedures of the entities. The National Audit Office also assessed the compliance of the procedures established by all agencies with the Public Procurement Act and analysed the adequacy of the procedures. The National Audit Office checked whether the procurement procedure required by law had been organised, whether the correct type of procedure had been selected and whether the requirements of the internal audit system and the Public Procurement Act had been observed in respect of the audited procurement procedures and simplified procurements.

54. The National Audit Office carried out on-site audit activities in nine public undertakings and foundations of the state: Enterprise Estonia, State Real Estate Company, North Estonia Medical Centre, Estonian Post, AS

### **Organisation of public procurements in state agencies, foundations and companies**

**Pursuant to the Public Procurement Act effective in 2012, a public procurement had to be organised if the expected cost of the procurement contract without VAT was**  
1) 400,000 euros in the case of a procurement contract for objects and services, and design contests; and  
2) 250,000 euros or more in the case of construction works or public works concession.

Metrosert, Tehvandi Sport Centre, AS Hoolekandeteenused, Viljandi Hospital and Tallinn Airport. Unlike state agencies, the procurement procedures that remained under the public procurement threshold were not audited in them.

55. The situation in ministries has improved in comparison to the previous year: the Public Procurement Act had generally been observed in the audited acquisitions, but the auditors also found some breaches.

56. The most common errors were as follows:

- No public procurement was organised, although it was required by law. This was found in the Ministry of the Environment, the Ministry of Culture, the Ministry of Finance, the Ministry of the Interior, the Ministry of Economic Affairs and Communications, the Ministry of Agriculture and the public undertakings and foundations Tehvandi Sport Centre, AS Hoolekandeteenused, Viljandi Hospital, Tallinn Airport and AS Vireen. It also included a **simplified procurement procedure**, which was not initiated with the publication of a notice in the Public Procurement Register. This was found in the Ministry of Culture, the Ministry of Agriculture, the Government Office, the Ministry of Defence, the Ministry of the Interior and the Ministry of Economic Affairs and Communications.
- The procurement procedure was not documented as required, misleading information was given in the Public Procurement Register, no written contract was entered into or contracts were entered into under terms and conditions different from those published in the register. This was found in the Ministry of Agriculture and the following public undertakings and foundations: North Estonia Medical Centre, Viljandi Hospital and AS Hoolekandeteenused.
- **Public procurement reports were** not submitted or they were submitted with delays. This was found in the Ministry of Education and Research, the Ministry of Defence, the Ministry of Economic Affairs and Communications, the Ministry of Culture, the Ministry of Agriculture, the Ministry of Finance, the Government Office, the Ministry of the Interior, the Ministry of Social Affairs, the Ministry of Foreign Affairs and the following state public undertakings and foundations: AS Hoolekandeteenused, Enterprise Estonia and North Estonia Medical Centre.
- **Procurement plans** had not been prepared, they were incomplete or not updated. This was found in the Ministry of Education and Research, the Ministry of Defence, the Ministry of Culture, the Ministry of Economic Affairs and Communications, the Ministry of Agriculture and the Ministry of Finance.

For example, the following data were missing from the procurement plans: estimated cost, type of procurement procedure, start time of procurement and person responsible for procurement. Procurements not included in the procurement plan had also been organised.

#### **Simplified procurement procedure**

starts with the publication of a simplified procurement notice in the register, as stipulated in the Public Procurement Act effective in 2012.

The obligation to organise a simplified procurement generally starts from 10,000 euros in the case of contracts for things and services, and 30,000 euros in the case of procurement of construction works.

#### **According to the Public Procurement Act**

valid in 2012, a **public procurement report** had to be submitted to the Public Procurement Register in the case of purchases of things and services from 10,000 euros and orders for construction works from 30,000 euros (without VAT) within 20 days of entry into the procurement contract. The annex to the public procurement report had to be submitted after the procurement procedure had come to an end.

**Procurement plan** – the planning document required by the Public Procurement Act, which approves the procurements planned for the fiscal year.

**The procurement procedure** regulates, among other things:

- 1) planning of a procurement and preparation and approval of an annual procurement plan;
- 2) appointment of persons responsible for the procurement, incl. for the performance of the procurement contract;
- 3) organisation of procurements below the public procurement threshold; and
- 4) organisation of services ordered by simplified procedure.

### Did you know that

The requirement of the Public Procurement Act which made the establishment of a procurement procedure obligatory for agencies/contracting authorities if the estimated total cost of the public procurements for things and services planned in one fiscal year exceeds 80,000 euros and if the estimated total cost of public procurements for construction works planned for the same period exceeds 500,000 euros entered into force in 2012.

**The internal control system** is a management tool that helps achieve the goals of the agency. This covers the whole process, incl. well-considered organisation of work, rules of conduct, compliance with laws, reporting and control. This is implemented by management as well as staff.

### Public undertakings as contracting authorities

- No **procurement procedure** had been prepared, or the procedure was in need of updating. This was found in the agencies of the Ministry of Education and Research, the Ministry of Economic Affairs and Communications, the Ministry of the Environment, the Ministry of Agriculture, the Ministry of Finance, the Ministry of the Interior and the Ministry of Foreign Affairs.

49 of the 84 undertakings and foundations had established internal procurement procedures. However, the National Audit Office found that in 15 of them the procurement procedures were not adequate considering the scale of procurement.

In the procurement procedures assessed as inadequate, the National Audit Office found the most omissions in the organisation of the work of the procurement committee, the transparency of procurement procedures and the organisation of management supervision, and agreeing on procurement activities. The responsibility of the persons engaged in procurement, deadlines or the connection of procurements with the budget had often not been specified.

57. The main shortcomings in the organisation of procurements are problems in the interpretation of the act, inconsistent implementation of the act in practice and insufficient experience or capability, especially in the case of smaller contracting authorities.

58. Breaches of the Public Procurement Act also indicate weaknesses in procurement planning, processing and the supervision system. The National Audit Office is of the opinion that the development and establishment of public procurement procedures is part of the **internal control system**, which must be created by the management of the agency and the ministry.

59. The Public Procurement Act does not stipulate any requirements for the contracting authority regarding the composition or review of the procurement plan, but the National Audit Office points out that the procurement plan is designed to help the contracting authority plan procurements. When the procurement plan is being prepared, the contracting authority has to think through its future procurements and also assess which procurements must be regarded as a set and which can be done separately, what type of procedure must be used etc. This in turn helps avoid illegal division of purchases into parts or mistakes being made in the selection of the type of procedure. This why the National Audit Office believes that a procurement plan must be sufficiently detailed and up to date.

60. The National Audit Office also checked whether all public undertakings had defined themselves as a contracting authority for the purposes of the Public Procurement Act. Five (Estonian Air Navigation Services, KredEx Credit Insurance, Teede Tehnokeskuse AS, AS Eesti Vanglatööstus and AS Eesti Loto) of the 26 undertakings found that they were not contracting authorities for the purposes of the Public Procurement Act.

61. As a result of the audit, the National Audit Office concluded that all of the abovementioned undertakings are contracting authorities for the

purposes of the Public Procurement Act and must organise their procurement activities according to the requirements set out in the act, because they provide services in public interest that are not industrial and/or commercial in nature.

### **Reorganisation of the professional activities of internal auditors is progressing slowly**

#### **Internal audit of the state**

62. In recent years there have been many changes that concern the internal auditors of the state. The most important of these are the amendment of the Government of the Republic Act, which assigned internal auditors the obligation to submit the internal auditor's report before the minister of the state secretary approves the annual report, to express an opinion on the implementation and efficiency of the internal control system; and the adoption of the Auditors Activities Act, which stipulates that the public sector internal auditors must acquire a qualification.

63. The Government of the Republic adopted the regulation 'General Rules for Internal Auditing of Authorities of Executive Power' (hereinafter the General Rules) in autumn 2012. The General rules established the principles for the management and organisation of internal audits and the procedure for implementation of the internal audit quality assurance programme and reporting on the activities of the internal audit division. Among other things, an internal audit division must establish internal audit procedures, set up regular internal assessments and organise external assessments of its division. Also, starting from 2013 a management report of the internal audit division, which has to meet specific content requirements, must be prepared.

64. The results of the survey carried out by the National Audit Office revealed that most divisions have already established internal audit procedures or are about to do so. However, not all internal audit divisions have carried out internal assessments and therefore have not organised external assessments either. According to the data of the Financial Control Department of the Ministry of Finance, five divisions were deemed to be generally in compliance with requirements as at the end of March 2013 (the Ministry of the Interior, the Police and Border Guard Board, the Ministry of Agriculture, the Estonian Agricultural Registers and Information Board and the General Staff of the Defence Forces). The main problems in internal audits highlighted by the Financial Control Department of the Ministry of Finance were that risk assessment was not documented in the preparation of work plans, work plans do not cover all internal audit activities, the number of IT audits carried out is insufficient, the quality of work papers is not even and the internal audit unit has no handbook.

65. 89 internal auditors worked in authorities of executive power as at the end of the May 2013. 10 internal auditors had acquired the necessary qualifications by the same time. More than 40 internal auditors have applied to take the exam. The responses given to the National Audit Office revealed that acquiring the qualifications of an internal auditor is considered necessary and people plan to acquire it. However, the management of some agencies does not consider qualification exams and

the acquisition of qualifications a priority because they find that it has no substantive relation to the quality of work.

66. In addition to the survey carried out among internal auditors, the auditors of the National Audit Office also met with the secretaries general of five ministries to find out whether they consider the work of internal auditors in the area of government of their ministry important and how satisfied they are with its quality. The secretaries general of the Ministry of Economic Affairs and Communications, the Ministry of the Interior, the Ministry of Education and Research, the Ministry of Agriculture and the Ministry of Finance were generally satisfied with the work of the internal audit divisions of their ministries in regard to the preparation of internal audit work plans, the importance of the topics selected for auditing, the handling of the problems highlighted in audit reports and the recommendations made. The secretaries general confirmed that acting on the recommendations made in internal audits is important. However, the ministries used different mechanisms to monitor the performance of recommendations and these mechanisms were largely based on the initiative of the internal audit divisions themselves. Several secretaries general admitted that the implementation of recommendations made by internal audit divisions should be made more systematic. The National Audit Office also asked whether external assessment of the quality of the internal audit division, which is required by the Auditors Activities Act, is considered important. All secretaries general except for the secretary general of the Ministry of Economic Affairs and Communications felt that an outsider's view of the division's activities added credibility to the work it was doing.

67. The feedback received from internal auditors indicates that they expect practical training, introduction of different practices and advice from the Ministry of Finance.

**68. Suggestion made by the National Audit Office to the Minister of Finance:** organise regular meetings and training for internal auditors and help them share their experiences.

**Response of the Minister of Finance:** We will consider the recommendations.

## Opinion on the accuracy of the Consolidated Annual Accounts of the State for 2012

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

**69. The annual accounts of the state, which indicate that the state's consolidated result for 2012 was 210.3 million euros and its total consolidated assets amounted to 11.7 billion euros as at 31 December 2012, 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 Standards of Estonia.**

70. In the management report presented as part of the Consolidated Annual Report of the State, the National Audit Office audited the

### Accuracy of annual accounts

correspondence of the figures given in the management report to those presented in the annual accounts.

71. The National Audit Office 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.

## Emphasising a fact

### State forest is recognised without consideration of its nature

72. Although the opinion of the National Audit Office regarding the state's annual accounts is unqualified, the accounting policies used to recognise the value of state forest are not suitable for state assets.

73. The value of state forest as a biological asset in the state's annual accounts as at 31 December 2012 is 776.7 million euros. The book value of state forest had not changed as at 2010 or 2011. However, the book value of biological assets in 2009 was 1.8 billion euros. The decrease in value was caused by the changes in accounting policies made in 2010.

74. The book value of state forest has not been revalued since the end of 2010, because in comparison to the sales price used to value the forest at the end of 2010 the average sales price of timber has not changed by more than 10%. According to methodology, the book value is not changed in such cases and it is again recognised at the same value as in the previous period.

75. All managed state forest was recognised in the balance sheet pursuant to the earlier accounting policies (non-managed forest was recognised as an off-balance sheet asset). The total value of state forest as a biological asset consisted of the value of the forest, nurseries and seed orchards. The value of seed orchards and nurseries was recognised at acquisition cost and all managed forest and its estimated increment were recognised at market value.

76. Only forest intended for cutting (or more specifically the timber obtained from this), which is found as an average for ten years on the basis of forecast data, has been recognised in the balance sheet since 2010. This means that recognition of monetary value based on existing state forest was replaced with recognition of the revenue obtained from sales of timber at its net present value. The state forest accounting methods were changed because the changes in the value of the asset in different years were great.

77. The National Audit Office is of the opinion that if the value of state forest is found solely via the value of forest intended for cutting, the actual value of the state asset (both as a whole and by forest type and tree species) or the changes occurring in the asset have not been considered. It must be considered that the quantity of managed state forest considerably exceeds the quantity of forest that is cut, but the accounting methods established with the General Rules of State Accountancy do not recognise this. The value of the state forest as a whole depends largely on the changes in the state forest, e.g. whether the forest left growing as a result of forest management has big or small reserves, whether they are coniferous or deciduous forests etc. Also, making a profit from forest cutting, as the annual accounts suggest, is not the only reason the state

## Did you know that

**Giving an unqualified opinion** means that the annual accounts are correct in all material respects.

**Giving an unqualified opinion with emphasising a fact** means that the annual accounts are correct in all material respects, but attention is drawn to a fact that is important in order to understand the information presented in the financial report.

**Giving a qualified opinion** means that the annual accounts are correct in all material respects, except for the facts highlighted in the opinion. An unqualified opinion is given if the errors that were found are significant in the context of the financial report.

**Disclaimer of opinion** means that the auditor was unable to obtain sufficient relevant evidence for expressing an opinion.

owns forest. Forest management covers growing, using, organising and protecting forest, and the impact of this on the value of the asset must also be considered. The National Audit Office is therefore of the opinion that indicating the revenue to be earned from the sale of timber as the value of the state forest is incorrect.

78. Suggestion made by the National Audit Office to the Minister of Finance: develop and establish new accounting policies for state forest which proceed from the nature of state forest and the asset as a whole.

**Response of the Minister of Finance:** The proposal of the National Audit Office basically means returning to the previous accounting policies. The opinion given in article 76 of the report that the accounting policies were changed because the value of the asset changed considerably in different years is not entirely correct. The main reason why the accounting policies were changed is that the formulas used according to the old accounting policies were extremely complicated and the results could not be checked (audited). Earlier calculations were based on the RITA database of the State Forest Management Centre. A large quantity of forest stands are recognised in this database. The data of each forest stand are changed about once every ten years as a result of stocktaking. The National Audit Office criticised the previous accounting methods and their implementation, and this criticism was thorough and justified. Implementation of new the accounting policies is much simpler and more understandable. According to the present accounting policies we recognise state forest in the balance sheet on the basis of the present value of the cash flow to be obtained from sales of forest in the future. We feel that the selected accounting policy is more suitable for state forest accounting than the previous accounting methods. The new accounting methods comply with international accounting standards, and they are relatively easy to implement and their results are understandable. This is why we do not intend to change the present accounting procedure.

### **Auditors have generally given unqualified opinions about the annual accounts of the foundations controlled by the state and the state's public undertakings**

#### **Opinions of certified auditors**

79. The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency. The National Audit Office has not audited these agencies and its opinion is based on the opinions of the certified auditors who audited their annual accounts. A summary of their opinions is given in Notes 1 and 2.

80. The opinions of the auditors of the annual accounts are unqualified except for the opinions provided for the annual accounts of AS Tallinna Sadam, AS Estonian Air and the Russian Theatre. Refusal to express an opinion about the annual report of AS Estonian Air has the biggest impact on the state's annual accounts.

81. The certified auditor refused to express an opinion on the annual accounts of AS Estonian Air because it was impossible to obtain sufficiently relevant evidence for the opinion. Namely, the auditor had no reassurance about the continuation of the company's operations, which was the basis for the preparation of the annual report. The value of the

shareholding in the unconsolidated balance sheet of the state is **zero euros**. According to the Generally Accepted Accounting Principles the book value of a shareholding is reduced to zero if the loss produced by an investment exceeds the book value of the shareholding.

## Accounting of state accounting entities and units

### Centralisation of accounting has evened out the level of accounting in the areas of government of ministries

82. The National Audit Office has consistently audited the level of organisation of accounting in ministries and the agencies in their areas of government. In the previous year the auditors found that the organisation of accounting had deteriorated in the areas of government of some ministries.

83. The project for combining all support services managed by the Ministry of Finance was launched in January 2010, its goal being to introduce the same financial and personnel accounting software and operating model in all state agencies by 2015. Accounting in the areas of government of the following ministries will be or has already been centralised within the scope of the project launched in 2010: The Ministry of the Interior, the Ministry of Finance, the Ministry of Justice, the Ministry of Culture, the Ministry of Social Affairs, the Ministry of Economic Affairs and Communications, the Ministry of Agriculture, the Ministry of the Environment and the Ministry of Education and Research.

84. The National Audit Office is of the opinion that the organisation of accounting has improved in most ministries and their areas of government. (The level of accounting in ministries is assessed in greater detail in the last chapter.) This also applies to the areas of government of the ministries where the National Audit Office found significant omissions in the previous year, which were mostly associated with the centralisation of accounting.

85. As at 1 June 2013, SAP business software had been implemented in the areas of government of the Ministry of Justice, the Ministry of Finance, the Ministry of Economic Affairs and Communications, the Ministry of the Interior, the Ministry of Agriculture, the Ministry of Social Affairs, the Ministry of the Environment and the Government Office. The area of government of the Ministry of Culture has started implementing SAP.

86. The National Audit Office finds that the centralisation of accounting and the introduction of single accounting software has evened out the level of accounting.

**Operating model of financial and personnel accounting** – description of work processes (incl. persons who complete them, deadlines and activities), which the accounting unit and the agency that is obliged to keep financial and personnel accounting have agreed on for the purpose of carrying out accounting.

87. The State Shared Service Centre (hereinafter the SSSC or the Centre) was created in late 2011 in the area of government of the Ministry of Finance on the basis of the Accounting Centre of the Courts of the Ministry of Justice. The objective of the creation of the Centre was to create an agency that would provide financial, personnel and payroll accounting services to the state. As at 1 June 2013, the accounting of the areas of government of the Ministry of Social Affairs, the Ministry of Finance and the Ministry of Economic Affairs and Communications had also been centralised into the Centre in addition to the Ministry of Justice. Every ministry has entered into a cooperation contract with the Centre in

order to obtain the service, and the [operating models of financial and personnel accounting form annexes to this contract](#).

88. Some problems have also emerged in the provision of the services. Namely, the SSSC has been providing financial accounting services to the Ministry of Social Affairs and the agencies in its area of government since the beginning of 2013. Preparation of the ministry's 2012 annual report was a duty of the Centre. The Centre is obliged to provide the internal auditors of the ministry, the National Audit Office and other control agencies with the data they need for the performance of their tasks. It must also be possible to review the accounting source documents of ministries and their agencies in the Centre.

89. The audit revealed that in many cases the Centre did not have the accounting source documents of the transactions and stocktakes performed in the ministry or its area of government, although the ministry or its agencies had placed them in the document management system or sent them to the Centre. An accountant from the Centre claimed that they did not have access to the ministry's information system in which the documents were kept. However, the ministry's representative claimed that the Centre had all of the necessary access and documents were also e-mailed if necessary. This indicates that cooperation between the ministry and the centre does not yet function in the agreed manner and the Shared Service Centre is unable to perform all of its obligations.

90. During the audited period there were no significant problems in the Ministry of Justice, which is the first ministry to which the Centre started providing its services, because the SSSC was created on the basis of the ministry's division and work on the same basis has been practised for several years.

91. Concentrating state accountancy into one centre is possible, but should not be a goal in itself. The National Audit Office believes that the development of support centres, the introduction of common IT solutions in the state and the centralisation of accounting in the areas of government of ministries is practical.

**92. Suggestion made by the National Audit Office to the Minister of Finance:** regularly assess the achievement of support service centralisation goals and the quality of the service, and organise an assessment of the impact of the activities of the State Shared Service Centre.

**Response of the Minister of Finance:** Similar to the State Shared Service Centre (hereinafter the SSSC) the support service centralisation project has a documented action plan and we constantly monitor its performance. The most important goal is to provide quality support services to the agencies served. We regularly communicate with the agencies to assess this goal. We are also planning to carry out a customer satisfaction survey this year.

### **Disclosure of transactions entered into with related parties in the reports of accounting entities is not regulated**

93. The Accounting Act requires that the accounting policies and procedures used in the preparation of the annual report are described in

## **Related parties**

the notes to the report and that all other information needed to give a true and fair view of the accounting entity's financial position, performance result and cash flow is disclosed. Transactions with executive management and members of the highest managing body as well as with other related parties must also be regarded as other important information. Description of the parties, the volume of transactions and balances as at the balance sheet date must be disclosed in the annual report.

94. The principles of treating related parties are not regulated in the General Rules of State Accountancy and state accounting entities are not required to disclose information about related parties in their annual accounts. State accounting entities (except for the Ministry of the Environment and the Office of the President of the Republic) have so far not disclosed information about related parties in their annual reports.

95. The National Audit Office is of the opinion that the information about related parties subject to disclosure in the annual reports of state accounting entities should cover a wide circle of persons. The National Audit Officer finds that it is necessary to consider whether harmonising the circle of persons according to the Corruption Act would be practical.

96. The National Audit Office also finds that disclosing information about related parties in annual reports makes the activities of state accounting entities more transparent and creates control over possible conflicts of interest, thereby creating pre-requisites for the prevention and early detection of corruptive transactions.

97. **Suggestion made by the National Audit Office to the Minister of Finance:** develop principles for the collection of information about related parties and require state accounting entities to disclose this information in annual reports.

**Response of the Minister of Finance:** We agree to discuss the principles of disclosure of information with state accounting entities and consider the establishment of additional requirements on the basis of the results of the discussion.

## Overview of government finances and reserves

### The situation in government finances has changed

98. The state's annual accounts and management report give expert readers a good overview of the situation and main trends in government finances. The National Audit Office analysed the trends of the state budget, state assets and liabilities in the last five years in the state's 2012 annual accounts for this chapter of the audit report. Analysing the information given in the state's annual accounts and management reports indicates that negative trends (i.e. increasing dependence on foreign support, increasing liabilities and decrease in budget flexibility) threaten the good condition of government finances.

99. State budget expenditure was cut considerably during the most difficult years of the recession – 2009 and 2010. Expenditure has started to grow again in the last two years compared to the previous years: 10%

## Government finances

in 2011 and 5% in 2012. In 2012 expenditure exceeded revenue by 87.2 million euros. The deficit was mainly financed from loans.

100. Foreign support has increased over the last five years: the share of foreign support in state revenue comprised 9% in 2008, but had increased to 19% of all revenue by 2012. The share of tax revenue decreased from 83% to 75% (see also Table 1). Such an excessive share of foreign support is a threat to government finances in the long term – when the amount of support starts to decrease, the state will have to choose whether to maintain the usual budget size and replace the amount of support with money collected as taxes, or to reduce the budget size considerably.

**Table 1. Unconsolidated revenue, expenditure and financing transactions of the state 2008-2012 (million euros)**

	Revenue, expenditure, financing transactions	2012	2011	2010	2009	2008
Actual implementation	Revenue, incl.	6,388.1	5,887.4	5,608.6	5,474.1	5,414.2
	taxes and social insurance payments	4,778.3	4,359.6	4,052.9	4,054.4	4,497.4
	support	1,187.4	1,136.8	1,146.7	830.2	464.8
	Expenditure	-6,475.3	-6,196.1	-5,601.9	-5,582.1	-5,712.3
	Financing transactions	-102.4	118.4	-129.9	427.0	222.2
Transfer to next year	Expenditure	-430.9	-599.7	-620.2	-338.2	-309.9
	Financing transactions	-7.5	0.0	0.0	0.0	0.0

Source: Annual Reports of the State 2012, 2011, 2010, 2009 and 2008

**Gross taxes receivable** – tax claims from which doubtful receivables have not been subtracted.

101. Taxes receivable decreased and doubtful taxes receivable increased as a result of the recession. Compared to 2008 taxes receivable decreased by 15% by 2010. At the same time the share of doubtful taxes receivable in gross taxes receivable increased from 33% to 41%. Taxes receivable grew during 2011 and 2012, but they have not yet reached the level of 2008. The share of doubtful taxes receivable in gross taxes receivable has decreased by 37%. It can therefore be concluded that tax receipts have improved in comparison to the years of recession, but there is still room for development. See also Table 2.

**Table 2. Consolidated receivables, doubtful receivables and prepayments 2008-2012 (million euros)**

Receivables/prepayments	2012	2011	2010	2009	2008
Taxes, fees and fines receivable (net)	670.5	650.0	621.7	696.6	728.3
Doubtful taxes, fees and fines receivable	-399.3	-425.1	-436.8	-400.5	-354.8
Collected prepayments of taxes, fees and fines	376.0	378.2	340.4	329.9	457.3

Source: Annual Reports of the State 2012, 2011, 2010, 2009 and 2008

102. The state's liabilities have increased constantly over the last five years. In 2012 total liabilities increased by 22% compared to the previous year, including a 41% increase in noncurrent liabilities and a 7% decrease in current liabilities. The increase in liabilities is the result of the loan taken from the European Investment Bank and Estonia's participation in the European Financial Stability Facility (see also articles 107-111). Compared to 2008 the volume of noncurrent liabilities has almost doubled (see also Table 3). In the long term this will bring about bigger

risks for government finances, because the elimination of stockpiled liabilities will inevitably lead to bigger budget expenditure.

103. It is stated in the State Budget Strategy 2014-2017 adopted with an order of the Government of the Republic of 25 April 2013 that the flexibility of the state budget is deteriorating according to forecasts, and the share of expenditure that depends on revenue and the expenditure related to the performance of the obligations determined by law in the budget is increasing. Non-fixed expenses comprised 29% of total budget expenditure in 2012, but the Ministry of Finance forecasts that the share of so-called available funds will decrease to 23% by 2017.

**Table 3. Consolidated assets and liabilities of the state 2008-2012 (million euros)**

Assets and liabilities	2012	2011	2010	2009	2008
<b>Assets, incl.</b>	<b>11,665.9</b>	<b>10,521.5</b>	<b>10,257.0</b>	<b>9,824.7</b>	<b>10,105.2</b>
current assets	2,857.3	2,730.9	3,130.5	3,000.5	2,762.5
fixed assets	8,808.6	7,790.6	7,126.5	6,824.2	7,342.7
<b>Liabilities, incl.</b>	<b>5,022.7</b>	<b>4,119.2</b>	<b>3,866.0</b>	<b>3,537.2</b>	<b>3,177.3</b>
current	1,519.3	1,638.3	1,706.1	1,291.3	1,499.8
noncurrent	3,503.4	2,480.9	2,159.9	2,245.9	1,677.6

Source: Annual Reports of the State 2012, 2011, 2010, 2009 and 2008

### The volume of the reserves managed by the State Treasury increased in the previous year

104. Compared to the previous year the total value of the reserves managed by the State Treasury increased by 515 million euros to 1.45 billion euros in 2012 (see also Table 4). The state's cash reserve increased by 501 million and was mainly influenced by the fact that the reserves of the Health Insurance Fund and the Unemployment Insurance Fund were added to the state's group account in the bank. The stabilisation reserve increased by 14.1 million euros to 347 million euros in 2012 – the financial income earned on the investment of the reserve comprised more than 3.3 million euros, the money raised from privatisation of land amounted to *ca.* 5.1 million euros and the amount received from the revenue of the Bank of Estonia amounted to *ca.* 5.7 million euros. The five-month growth of the stabilisation reserve in 2013 was mostly generated by the profit allocations of the Bank of Estonia in the amount of 8.5 million euros that were paid into the reserve.

105. The reserves of the Estonian Health Insurance Fund and the Estonian Unemployment Insurance Fund were added to the state's cash reserve on the basis of a resolution made by the Riigikogu. The Ministry of Finance entered into deposit contracts with the Health Insurance Fund and the Unemployment Insurance Fund to add their reserves to the **state's group account**. According to the contracts, the bank accounts of the Health Insurance Fund were added to the state's group account in December 2011 and the bank accounts of the Unemployment Insurance Fund in January 2012. It was also agreed that the interest paid on the reserves of the Health Insurance Fund and the Unemployment Insurance Fund would be equal to the **returns on the state's cash reserve**. The State Treasury

### Reserves of the State Treasury

**State's group account** – accounts opened in banks that service the state budget, belong to the State Treasury and are used for the state's settlements.

**Return on state's cash reserve** – revenue earned on successful investments of the cash reserve in bonds, deposits and other financial instruments as a percentage.

purchased the bonds in the reserve capital and cash reserve of the Health Insurance Fund for the market prices and they will be recognised in the cash reserve in the future. The bonds in the reserve capital of the Unemployment Insurance Fund were sold. The Unemployment Insurance Fund transferred the money to the State Treasury and it is now managed and invested by the State Treasury. The money invested in term deposits was added to the group account following the expiry of the deposit terms in January, February and March 2012.

106. Pursuant to the State Assets Act, the state's foundations also keep their money in the State Treasury and the everyday settlements of the foundations are made via the State Treasury similar to state agencies. The money of foundations is held with the other money managed by the State Treasury. According to the cooperation contracts entered into between the ministry and foundations, foundations are paid interest on the average monthly balance of the money held in the State Treasury at a rate that equals the [deposit facility rate](#).

**Deposit facility rate** – the interest rate paid by the central bank on the money deposited with them, which is generally the minimum limit of the money market interest level.

**Table 4. Market value of reserves managed by State Treasury (euros)**

Name of reserve	Market value		
	31.12.2011	31.12.2012	31.05.2013
Stabilisation Reserve Fund	332,978,128	347,032,206	357,642,346
State's cash reserve, incl.	604,891,317	1,106,153,630	1,004,321,717
state	247,433,608	273,470,186	150,705,097
reserve funds for ownership reform	31,253,115	32,945,089	11,367,004
funds of Health Insurance Fund*	164,403,584	204,299,859	178,651,713
funds of Unemployment Insurance Fund**	0	471,681,157	499,902,975
foundations and European Commission***	161,801,010	123,757,339	163,694,928
reserve capital of Health Insurance Fund*	6,210,104	0	0
cash reserves of Health Insurance Fund*	27,369,866	0	0
reserve capital of Unemployment Insurance Fund**	25,548,509	0	0
<b>Total</b>	<b>996,997,924</b>	<b>1,453,185,836</b>	<b>1,361,964,063</b>

\* The legal reserve and cash reserve of the Health Insurance Fund were added to the state's group account in late 2011 and early 2012.

\*\* The legal reserve of the Unemployment Insurance Fund was added to the state's group account in early 2012.

\*\*\* The money of foundations and the European Commission is also in the state's cash reserve.

Source: State Treasury Department of the Ministry of Finance

## Liabilities of the state

**State's unconsolidated balance of loans payable** – the sum of the state's loans payable, which covers ministries, the State Treasury and constitutional institutions.

107. The loans payable by the state include loans assumed, bonds issued and obligations assumed with capital lease contracts. [The state's unconsolidated balance](#) of loans payable as at 31 December 2012 was 999.7 million euros, which increased by 718.8 million euros in comparison to the previous reporting period. The state has not issued bonds in the financial year, but it has borrowed money. The interest paid on borrower amounts in the previous year totalled 4.5 million euros (incl. the loan from the European Investment Bank) and loan principal repayments amounted to 3.5 million euros.

108. A loan agreement for borrowing 550 million euros was entered into with the European Investment Bank in 2009 on the basis of a resolution of the Government of the Republic. 165 million euros of this amount was

taken in 2009. No additional money was drawn down from the loan amount agreed with the EIB in either 2010 or 2011. The remaining 385 million euros were drawn down in July 2012 and this amount must be repaid by 2025. Interest payments on this amount started immediately and the interest so far paid on the EIB loan totals 9.1 million euros, incl. the 4.2 million euros paid in 2012. The loan from EIB was taken for co-financing European Union support.

109. The state has granted loan guarantees to its foundations. The balance of the loan as at 31 December 2012 was 33.3 million euros. The balance of the loans guaranteed by the state increased by 6.3 million euros in comparison to the previous year. The Republic of Estonia has also entered into guarantee contracts with the Nordic Investment Bank on the basis of which Estonia guarantees project-based investment loans and securities of up to 13.1 million and environmental investment loans and securities of up to 2.2 million euros.

110. On 29 September 2011 the Riigikogu adopted a resolution to join the **European Financial Stability Facility (EFSF)**, to which the state of Estonia has a guarantee obligation of 1.99 billion euros. As of 31 December 2012 the share of Estonia in the amount re-lent by the EFSF was 354.8 million euros, which is recognised as a liability in the state's accounting.

111. According to the unconsolidated balance sheet of the state, the state had granted off-balance sheet guarantee obligations in the total amount of 1.74 billion euros by the end of 2012. In addition to the EFSF the state also has smaller guarantee obligations, e.g. to the European Investment Bank and the Council of Europe Development Bank.

112. The largest permitted loan balance pursuant to the 2012 State Budget Act was 1.5 billion euros for the budget loan and 1.1 million euros for the cash loan. Without considering the guarantees granted by the state, which have been approved by the Riigikogu, the loans taken as at 31 December 2012 did not exceed the limits established in the State Budget Act.

## Main observations in the financial audits of ministries

113. Summaries of the audits performed in ministries are given below. The National Audit Office 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 National Audit Office.

### Accounting errors were found in the Ministry of Education and Research

114. The budget expenditure of the area of government of the Ministry of Education and Research in 2012 amounted to 477 million euros, which decreased by 19.8 million euros compared to the previous year. In 2012 the ministry made investments of 48 million euros, mostly in the renovation and furnishing of schoolhouses. Labour costs amounted to 81 million euros.

115. The number of agencies in the area of government of the Ministry of Education and Research as at year end was 74. Four agencies (the State Examination and Qualification Centre, Vana-Antsla Vocational School,

**European Financial Stability Facility (EFSF)** – a private legal entity that is owned by members of the eurozone. The EFSF may grant loans to eurozone members to support economic reforms. The EFSF borrows the funds required for granting loans from the financial market using the guarantees given by the owners.

### Ministry of Education and Research

Tallinn Pedagogical College and Helme Sanatorium Boarding School) terminated their operations in 2012 and two new agencies were established (the National Archive and Viljandi Upper Secondary School). The average number of employees in the area of government in 2012 was 5,399.

**116.** The annual accounts 2012 of the Ministry of Education and Research give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the Ministry of Education and Research has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

**117.** The Financial Department of the ministry has created pre-requisites for the organisation of the accounting of the ministry and the agencies in its area of government; for example, the procedures that regulate accounting exist and are up-to-date, and the employees of the Financial Department of the ministry have actively helped resolve issues that have emerged in accounting. Irrespective of the pre-requisites created, the agencies in the area of government made more mistakes in fixed asset accounting and in the recognition of other economic transactions than in previous years. One of the reasons here is the completion of several large renovation projects and the large number of non-routine transactions associated therewith.

**118.** The ministry had centralised the accounting of 30 general education schools by the beginning of 2012, which means that accounting in these schools is organised by the accounting division of the ministry. The accounting of Luua Forestry School, the Estonian Language Inspectorate, the Institute of the Estonian Language and the Estonian Literary Museum was also centralised in 2012. 28 vocational educational institutions and seven institutions of professional higher education are still doing their accounting on site, but the centralisation of their accounting should be completed by 2015. The National Audit Office is of the opinion that the centralisation of accounting has helped harmonise the level of accounting, which is a problem mainly in smaller agencies.

**119.** Compared to the previous year the volume of fixed assets in the ministry's area of government increased by 40.4 million euros (*ca.* 12%), mainly in relation to the completion of the construction and renovation of schoolhouses. Regardless of some small problems, the organisation of the acquisition and use of assets is at a good level and the preservation of assets is guaranteed.

**120.** Although the National Audit Office found no serious breaches in the organisation of procurements, there were still small problems in compliance with the Public Procurement Act. Agencies in the area of government must update their procurement procedures and procurement plans. They should also pay more attention to the organisation of simplified procurements: problems in this area were found in many agencies.

## Ministry of Justice

### Accounting in the Ministry of Justice is at a good level.

121. The budget expenditure of the Ministry of Justice in 2012 was 114.8 million euros – an increase of 9.5 million euros compared to 2011. Investments were made in the amount of 3.5 million and labour costs amounted to 73.8 million euros. The revenue received in the area of government of the Ministry of Justice in 2012 amounted to 29.5 million euros.

122. The number of agencies in the area of government of the Ministry of Justice is 18 and the average number of employees in the area of government in 2012 was 3,283.

123. The annual accounts 2012 of the Ministry of Justice give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

124. The State Shared Service Centre, which started providing financial, personnel and payroll accounting services to state accounting entities, was established in 2012 on the basis of the Accounting Centre of Courts that belonged to the area of government of the Ministry of Justice. In 2012 the Centre provided services to the Ministry of Justice and the agencies in its area of government, and in 2013 it also started providing the services to other ministries that centralised their financial, personnel and payroll accounting (the Ministry of Finance, the Ministry of Social Affairs and the Ministry of Economic Affairs and Communications). As the Centre was established on the basis of the Ministry of Justice, it did not result in big changes in the organisation of the ministry's accounting. Centralisation of accounting has actually improved the organisation of financial, personnel and payroll accounting in the Ministry of Justice even further.

125. The amount of assets recognised in the balance sheet of the ministry as at 31 December 2012 was 112 million euros. The volume of the assets of the Ministry of Justice decreased by 4.5 million euros (46%) compared to 2011. The Patent Board building, Harku Prison and the Maardu Unit of Tallinn Prison, which used to be managed by the Ministry of Justice, were transferred to Riigi Kinnisvara AS in 2012.

126. Accounting of assets in the ministry is good and the existence of assets in the ministry is ensured. No problems in compliance with the Public Procurement Act were found in the course of the audit.

### The level of accounting in the Ministry of Defence is good.

## Ministry of Defence

127. The budget expenditure of the area of government of the Ministry of Defence in 2012 amounted to 341.4 million euros – an increase of 62 million euros or 22% compared to the previous year. Defence expenditure comprised 339.9 million euros in the budget for 2012 – an increase of 59.9 million euros compared to 2011. The biggest shares of the area of government's expenditure comprise special equipment procurements (29.2%), personnel expenses (22.4%) and management costs (19.9%).

246.7 million euros from the budget for 2012 was invested and 76 million euros was spent on labour costs.

**128.** The number of agencies in the area of government of the Ministry of Defence is six and the average number of employees in the area of government in 2012 was 4,317.

**129.** The Minister of Defence was authorised to decide on the dissolution of OÜ E-Arsenal with an order of the Government of the Republic. On 31 May 2012 the minister decided to dissolve OÜ E-Arsenal and to initiate liquidation proceedings. The liquidation entry of the private limited company was made on 13 February 2013.

**130.** The annual accounts 2012 of the Ministry of Defence give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

**131.** The organisation of accounting in the ministry's area of government is at a good level, regulating procedures exist and internal control systems are functional. Accounting in the area of government is partly centralised. Accounting of the ministry, the Information Board, the Defence Resources Agency, the Seli Health Centre and the Estonian War Museum – General Laidoner Museum is centralised in the ministry. The Defence Forces organise their own accounting. The area of government of the Ministry of Defence has not yet transferred to SAP business software.

**132.** The asset volume of the area of government of the Ministry of Defence in 2012 amounted to 439.6 million euros – an increase of 29 million euros compared to the previous year. The majority of fixed assets are unfinished projects, e.g. payments have been made for two mid-range air surveillance radars and vehicles. The Ministry of Defence transferred 60 apartment ownerships and four registered immovables to Riigi Kinnisvara AS to a total ordinary value of 0.9 million euros. The organisation of the acquisition and use of assets in the ministry is at a good level, except for the fact that some apartments belonging to the Defence Forces are still being used under conditions that are unfavourable for the state.

**133.** There were no significant breaches of the Public Procurement Act in the acquisitions made by the ministry and the Defence Forces, but errors were found in the organisation of the ministry's procurements. For example, the Procurement Department of the ministry only has a partial overview of the procurements made in 2012 and the procurements made by the Procurement Department for defence purposes are recognised in the information system, but the procurements made in the other departments of the ministry are not recognised. The ministry does have a plan of procurements for defence purposes, but there is no economic procurement plan and adherence to procurement contracts is not supervised.

## Ministry of the Environment

### Organisation of accounting in the Ministry of the Environment has improved

134. The budget expenditure of the Ministry of the Environment in 2012 was 245 million euros – a decrease of 164 million euros compared to the previous year. This change is associated with a decrease in proceeds from sales of pollution quotas. The ministry made investments of 4 million euros, mostly acquiring land and IT equipment and developing and updating information systems. The budget revenue of the Ministry of the Environment in 2012 was 336 million euros, which decreased by 90 million compared to the previous year, mostly as a result of a decrease in support received.

135. The number of agencies in the area of government of the Ministry of the Environment is eight and the average number of employees in the area of government in 2012 was 1,422. The Information Technology Centre of the Ministry of the Interior started operating on 1 January 2013.

136. The annual accounts 2012 of the Ministry of the Environment give a true and fair view of the ministry's financial position, performance result and cash flow in all material respects.

137. Although the National Audit Office provided an unqualified opinion on the annual accounts of the Ministry of the Environment, we would like to draw attention to the principles of state forest accounting and recognition. The National Audit Office is of the opinion that the accounting policies of state forest recognition that were amended in 2010 are not suitable for state forest. According to the method established with the General Rules of State Accountancy the value of state forest is found only via the value of the forest planned to be cut, and the actual value of the state asset and the changes occurring in the asset are not considered. Also, no information about state forest is presented in the annual accounts of the ministry.

138. Accounting in the area of government of the Ministry of the Environment has improved compared to previous years: internal accounting procedures and other procedures that regulate accounting exist and they have been updated and implemented in everyday work. Centralisation of accounting started in 2009.

139. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the Ministry of the Environment and the agencies in its area of government have complied with the requirements of said acts. The funds allocated for investment and labour costs were used expediently.

140. Compliance with the Public Procurement Act has generally been good, but two unperformed procurement procedures were found in the course of the audit. The procurement procedures of the Ministry of the Environment and its divisions are generally at a good level.

141. The asset volume of the Ministry of the Environment in 2012 was 1.5 billion euros – a decrease of 169 million euros compared to the previous year. The change that occurred in 2012 is related to the decrease in prepayments received, as less money was earned from sales of pollution quotas. The National Audit Office is of the opinion that the organisation

of the acquisition and use of assets is at a good level and the preservation of assets is guaranteed.

### **Centralisation of the accounting of agencies continues in the Ministry of Culture**

#### **Ministry of Culture**

142. The budget expenditure of the area of government of the Ministry of Culture in 2012 amounted to 166.5 million euros – an increase of 4.8 million euros compared to the previous year. In 2012 the ministry made investments of 7.2 million euros, the money mostly being spent on construction and renovation of museums. Labour costs in the ministry's area of government amounted to 24.9 million euros.

143. The number of agencies in the area of government of the Ministry of the Culture at year end was 38 and the average number of employees in 2012 was 1,739. Pärnu Theatre Endla stopped operating as a public undertaking at the end of April 2012 and it is now a foundation. Liquidation of the public undertakings Theatre Vanemuine, Theatre Vanalinnastudio and the Estonian National Puppet Theatre started in November 2012. New foundations were established at the same time: NO99, Theatre Vanemuine and the NUKU Foundation. Narva Museum was also founded in addition to the theatres.

144. The annual accounts 2012 of the Ministry of Culture give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs were used expediently.

145. Centralisation of accounting in the area of government in the ministry and its transfer to the SAP programme continued in the financial year. Accounting in six agencies (incl. the ministry, Võru Institute, the Estonian Health Care Museum, the Repository Library of Estonia, the Estonian Children's Literature Centre and the National Heritage Board) has been centralised by year end. The National Audit Office finds that the centralisation of accounting in the ministry has evened out the level of accounting. Centralisation of the accounting of the entire area of government and the transfer to SAP software should be finalised in 2015.

146. The organisation of accounting in the Ministry of Culture and the agencies in its area of government has improved, but the levels of agencies remain different and mistakes are still being made. The biggest number of mistakes was found in the fixed asset and labour cost accounting in Conservation Centre Kanut. The procedures required for the organisation of accounting in the ministry and the agencies in its area of government exist, but they must be updated and brought into compliance with the amendments made to the General Rules of State Accountancy and the operating model of financial and personnel accounting that entered into force in the ministry in December 2011.

147. Compared to the previous year the volume of fixed assets in the ministry's area of government decreased by 6.4 million euros (*ca.* 3%), mainly in relation to the transfer of 21 properties to Riigi Kinnisvara AS. The transfer of assets to the established foundation in the course of the

dissolution of four agencies in the area of government also has an impact on the volume of fixed assets. Regardless of some small problems, the organisation of the acquisition and use of assets is generally at a good level and the preservation of assets is guaranteed.

148. The Public Procurement Act was also breached in the area of government of the Ministry of Culture in 2012, as the ministry failed to organise certain procurement procedures, e.g. for purchasing air transport services for itself and the State Concert Institute Eesti Kontsert, and for purchasing food in the Estonian Maritime Museum. The procurement procedures of the ministry and the agencies in its area of government generally guarantee that the Public Procurement Act is complied with, but the procurement plan must be updated and made more informative. It is also necessary to pay more attention to the organisation of simplified procurements: problems in this area were found in many agencies.

### **Accounting in the Ministry of Economic Affairs and Communications has improved considerably**

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

149. The budget expenditure of the area of government of the Ministry of Economic Affairs and Communications in 2012 was 588 million euros – an increase of 37 million euros compared to the previous year. The increase is mainly the result of an increase in the appropriations granted for investments and as support for public transport (21 million euros). The ministry invested 187 million euros, mainly in road construction and repairs (153 million euros). The number of agencies in the area of government of the Ministry of Economic Affairs and Communications is nine and the average number of employees in the area of government in 2012 was 1,333.

150. The annual accounts 2012 of the Ministry of Economic Affairs and Communications give a true and fair view of the ministry's financial position, performance result and cash flow in all material respects. Accounting of the ministry's areas of government has been centralised in the ministry and has improved considerably compared to previous years. SAP business software was used for accounting in the entire area of government for the second year.

151. No accounting errors were found in the Ministry of Economic Affairs and Communications, but mistakes were made in compliance with laws.

152. The National Audit Office also audited compliance with the State Budget Act and the 2012 State Budget Act and found that the Ministry of Economic Affairs and Communications and the agencies in its area of government had generally complied with the requirements of said acts, except for entering into the kind of lease contract that created obligations that the agencies in the area of government did not consider financing transactions during preparation of the budget. Entering into such contracts is prohibited by the State Budget Act if they are not stipulated in the annual state budget act.

153. The ministry and the agencies in its area of government used the funds allocated for investments and labour costs for their intended purpose.

154. The ministry and the agencies in its area of government have generally acted prudently and according to the applicable rules in acquiring and transferring assets. Errors were found in contracts granting use of quarries made by the Road Administration, as they did not comply with the requirements established in the regulation of the Government of the Republic.

155. The Ministry of Economic Affairs and Communications and agencies in its area of government have breached the Public Procurement Act: the relevant procurement procedures were not carried out (in three cases), and there were delays in the submission of public procurement reports and their annexes to the public procurement register (25 cases in total). Also, the procurement procedures of all agencies were not sufficiently thorough.

156. The asset volume of the area of government of the Ministry of Economic Affairs and Communications in 2012 was 4.1 billion euros – an increase of 224 million euros compared to the previous year. The changes that occurred in 2012 are mainly associated with an increase in the ministry's holdings in subsidiaries and affiliates. The ministry also transferred the buildings it does not require for the exercising of state authority to Riigi Kinnisvara AS.

#### **Accounting in the Ministry of Agriculture has improved during the year**

#### **Ministry of Agriculture**

157. The budget expenditure of the area of government of the Ministry of Agriculture in 2012 amounted to 370.2 million euros – an increase of 24.3 million euros compared to the previous year. In 2012 the ministry made investments of 3.3 million euros. The biggest investments were made in the renovation of a building in Paide in order to relocate all of the ministry's agencies located in Paide to the same building. Labour costs amounted to 26.5 million euros.

158. The number of agencies in the area of government of the Ministry of Agriculture was 13 at the end of the year. The number of agencies did not change in the financial year. The average number of employees in the area of government in 2012 was 1749.

159. The annual accounts 2012 of the Ministry of Agriculture give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

160. Accounting in all agencies of the Ministry of Agriculture (except for the Estonian Agricultural Registers and Information Board and the Estonian Animal Recording Centre) has been centralised and SAP business software is used.

161. The organisation of accounting in all divisions with centralised financial accounting has improved significantly in all areas of accounting. The fact that the ministry's agencies approved their internal financial accounting procedures in compliance with the operating model of financial, personnel and payroll accounting has contributed considerably

to the improvement of the organisation of accounting. The internal control system in agencies has been strengthened as a result of this. However, errors were found in asset accounting and one of the reasons that can be highlighted is the fact that the accounting policies used for fixed asset improvement accounting have not been regulated in the ministry's accounting policies and procedures and the employees who deal with assets in agencies are now aware of the requirements for fixed asset accounting. The level of accounting in the agencies where financial accounting has not yet been centralised – the Estonian Agricultural Registers and Information Board and the Estonian Animal Recording Centre – is at a good level. There are plans to centralise financial and personnel accounting in these agencies in 2014.

**162.** Compared to the previous year the volume of fixed assets in the ministry's area of government increased by 7 million euros (*ca.* 9.7%) and the construction and renovation of the building in Paide was completed. The renovation of the Haapsalu office building of the Agricultural Board, two museums, the laboratory building of the Agricultural Research Centre and the experimental laboratory of the Jõgeva Plant Breeding Institute was also completed. Three registered immovables not needed by the Ministry of Agriculture were transferred to Riigi Kinnisvara AS. Regardless of a few problems in accounting, the organisation of the acquisition and use of assets is generally at a good level and the preservation of assets is guaranteed.

**163.** Except for the Jõgeva Plant Breeding Institute, where a number of problems were found in the organisation of procurement procedures, the National Audit Office did not find any open procurements that had not been organised and the Public Procurement Act had generally been complied with in the open procurement procedures organised. Agencies in the area of government must update their procurement procedures and procurement plans. They should also pay more attention to the organisation of simplified procurements: problems in this area were found in many agencies.

### **Accounting in the Ministry of Finance is in order**

#### **Ministry of Finance**

**164.** The budget expenditure of the Ministry of Finance in 2012 was 1.7 billion euros – an increase of 246 million euros compared to the previous year. For example, the state's payments into the mandatory funded pension fund increased by 83 million euros and expenditure incurred on the account of proceeds received from sales of pollution quotas increased by 127 million euros. The ministry invested 6 million euros, mainly in the development of information systems and the acquisition of licences and IT equipment.

**165.** There are five agencies in the area of government of the Ministry of Finance; the Information Technology Centre of the Ministry of Finance (RMIT) and the State Shared Service Centre started operating in 2012. The average number of employees in the area of government in 2012 was 2,889.

**166.** The annual accounts 2012 of the area of government of the Ministry of Finance give a true and fair view of the ministry's financial position, performance result and cash flow in all material respects. Accounting in

the ministry's area of government has been centralised, it is at a good level and SAP business software is used.

167. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

168. However, the National Audit Office found that the Tax and Customs Board has paid Baltic Banknote LLC compensation in the amount of 71,182 euros by way of a compromise, but the National Audit Office is of the opinion that ordering the payment of this compensation was not sufficiently justified or transparent. This was a dispute caused by the termination of a public procurement, whereby a claim for compensation of damages was not submitted to the Public Procurement Dispute Committee and the court did not order payment of this compensation either.

169. The Ministry and the agencies in its area of government have generally acted prudently and according to the rules in acquiring and transferring intangible and tangible assets. The Public Procurement Act has generally been complied with, except for two unperformed procurement procedures.

170. The asset volume of the Ministry of Agriculture in 2012 was 2.6 billion euros – an increase of 499 million euros compared to the previous year. The majority of this comprised an increase in long-term loans payable (341 million euros) caused by Estonia joining the EFSF.

### **The level of accounting in the Ministry of the Interior is good.**

#### **Ministry of the Interior**

171. The budget expenditure of the Ministry of the Interior was 436 million euros – an increase of 20 million euros compared to 2011. The ministry's area of government invested 41 million euros in 2012, mainly in the acquisition of multifunctional ship and rescue equipment and the development of information technology. Labour costs in the ministry's area of government amounted to 151 million euros. Budget revenue in 2012 amounted to 191 million euros – an increase of 17 million euros compared to 2011.

172. There were 28 agencies in the area of government of the Ministry of the Interior in 2012 (20 of them being county governments and the agencies managed by them). The average number of employees in the area of government was 9,555; the number of employees had decreased by 343 compared to the previous year.

173. The annual accounts 2012 of the Ministry of the Interior give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

174. The Ministry of the Interior has centralised financial, personnel and payroll accounting in its area of government, i.e. accounting is organised by the ministry or the central agency. The accounting of county governments is concentrated separately in Viljandi County Government. Financial and personal accounting in the Estonian Public Service Academy had not been centralised by the end of 2012. The ministry's agencies, except for the Estonian Public Service Academy, have transferred to SAP business software.

175. The organisation of accounting in the ministry and in the agencies within its area of government is good. Errors have been made in stocktakes of fines receivable, because only 38 of 49 bailiffs have feedback and part of the balance of fines receivable had not been compared by the time these annual accounts were prepared. As the amount of fines receivable has been claimed with the data of bailiffs only in part, the stocktake of fines receivable cannot be considered completed and the probability of their receipt cannot be evaluated.

176. The ministry's assets amounted to 327 million euros as at 31 December 2012. Their amount decreased by 4.7% during 2012. The agencies in the area of government of the Ministry of the Interior started transferring assets to Riigi Kinnisvara AS in 2011. 277 properties had been transferred to RKAS as at 31 December 2012. The ministry needed 102 of these properties for its main activities and entered into lease contracts for their use. The ministry did not require the remaining 175 properties. It plans to transfer *ca.* 60 necessary and *ca.* 30 unnecessary properties in 2013. The organisation of the acquisition and use of assets in the Ministry of the Interior is at a good level.

177. There are still some problems in compliance with the Public Procurement Act in the Ministry of the Interior. Several county governments have ordered services without organising procurements. The Rescue Board has acquired spare parts and ordered maintenance services without organising a procurement. The Estonian Public Service Academy has initiated simplified procurements without informing the Public Procurement Register about them.

### **Cooperation between the Ministry of Social Affairs and the State Shared Service Centre must be improved**

#### **Ministry of Social Affairs**

178. The budget of the area of government of the Ministry of Social Affairs was 2.74 billion euros – 111 million euros more than the budget for 2011. The budget increased mostly on the account of an increase in social benefits. In 2012 the ministry made investments of 21 million euros and paid 24 million euros in labour costs.

179. There are 10 agencies in the area of government of the Ministry of Social Affairs. The activities of the Illuka Reception Centre for Asylum Seekers were terminated on 21 April 2012 and the provision of the service taken over by AS Hoolekandeteenus. The average number of employees in the ministry's area of government in 2012 was 1,522.

180. The annual accounts 2012 of the Ministry of Social Affairs give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State

Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently.

**181.** The financial and personnel accounting of the Health Board, the State Agency of Medicines, the Labour Inspectorate, the National Institute for Health Development, the Astangu Vocational Rehabilitation Centre, the Illuka Reception Centre for Asylum Seekers, the Office of the Public Conciliator, the Gender Equality and Equal Treatment Commissioner and the Office of the Gender Equality and Equal Treatment Commissioner were merged in the accounting of the Ministry of Social Affairs as at 31 December 2012.

**182.** The final centralisation of the area of government occurred on 1 January 2012 when accounting in the Social Insurance Board was centralised. The State Shared Service Centre has provided financial and personnel accounting services to the area of government of the Ministry of Social Affairs since then.

**183.** Accounting in the Ministry of Social Affairs and the agencies in its area of government is generally organised as required. The necessary accounting policies and procedures have been established in the area of government, but cooperation between the ministry and the Shared Service Centre is not yet functioning in the agreed manner and the Shared Service Centre is unable to perform all of the obligations set forth in the agreement between the two agencies.

**184.** The amount of assets recognised in the balance sheet of the ministry as at 31 December 2012 was 369 million euros. The assets of the area of government increased by 143 million euros during the year, incl. an increase in social taxes receivable from the Tax and Customs Board. The Ministry of Social Affairs transferred 14 properties to Riigi Kinnisvara AS on 31 January 2013 (incl. properties on Gonsiori Street and Paldiski Road, Tallinn).

**185.** Asset accounting is at a good level in the ministry, but there are still omissions in the organisation and documentation of stocktakes of assets and liabilities.

**186.** No problems in compliance with the Public Procurement Act were found in the course of the audit. The established procurement procedure is sufficient and in compliance with the Public Procurement Act.

### **Accounting in the Ministry of Foreign Affairs is in order**

#### **Ministry of Foreign Affairs**

**187.** The budget expenditure of the Ministry of Foreign Affairs in 2012 amounted to 53.1 million euros – a decrease of 6.5 million euros compared to the previous year. The ministry invested 7.5 million euros in 2012, construction investments made by foreign missions being the most significant. Operating expenses comprised 35.4 million euros. 10.3 million euros was spent on appropriations, the majority of which were membership fees of international organisations, and development and humanitarian aid.

**188.** The Ministry of Foreign Affairs had 46 foreign missions in 2012, and one new foreign mission started operating during the year. Estonia has 33

embassies, seven permanent representations in international organisations, four consulates general, one office, one special mission and 158 honorary consuls in foreign countries.

**189.** The annual accounts 2012 of the Ministry of Foreign Affairs give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The level of organisation of accounting in the Ministry of Foreign Affairs is good in the opinion of the National Audit Office. Procedures regulating accounting are up-to-date and their performance is monitored.

**190.** The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2012 State Budget Act and found that the ministry has complied with the requirements of said acts. The funds allocated for fixed asset investments and labour costs had been used expediently. No significant errors were found in compliance with the requirements of the Public Procurement Act, but the procurement procedure of the ministry must be updated.

**191.** The asset volume of the Ministry of Foreign Affairs in 2012 was 92.5 million euros – an increase of 7.5 million euros compared to the previous year. The increase that occurred in 2012 was mainly associated with an increase in volume of tangible fixed assets by 6 million euros and was caused by the renovation and construction works of foreign missions.

/digitally signed/

Alar Karis  
Auditor General

## Recommendations made by National Audit Office and responses of the Minister of Finance

On the basis of the audit, the National Audit Office made several recommendations to the Ministry of Finance. The minister sent his response to the recommendations made by the National Audit Office on 2 August 2013.

General comments on the audit report
<p>The performances and proposals given by the National Audit Office in the report focus on the topics that we have to continue dealing with.</p> <p>We would like to thank the National Audit Office for its work and hope that constructive cooperation will continue between us in future.</p>

Recommendations of the National Audit Office	Response of the Minister of Finance
<p><b>State budget and Budget Execution Report</b></p> <p><b>13. Recommendation of the National Audit Office to the Minister of Finance:</b> continue streamlining the principles of budgeting to guarantee transparency and clarity by eliminating the omissions highlighted in this and previous reports, including</p> <ul style="list-style-type: none"> <li>▪ review the manner of presentation of the State Budget Execution Report , add a separate column about the budget of the expenditure transferred from the previous year to the report and highlight the amount of the expenses incurred for the transferred money next to the actual implementation of the budget;</li> <li>▪ plan the revenue and expenditure in the budget for the ministries to whose main activities they relate and report on the implementation of this by the same ministry.</li> </ul> <p>(articles 4-15)</p>	<p><b>Response of the Minister of Finance:</b> Similar to the National Audit Office we also consider it important to continue improving the transparency and comprehensibility of the budget and its implementation report (which is why the budget act is being presented in amended format from 2013).</p> <p>The initial and final budgets are presented in the Budget Execution Report . The budget of the expenditure transferred from the previous year is also included in the final report. If we submitted an additional column just for the budgets transferred from the previous year, it would raise the question as to why other budget adjustments which change the initial budget in comparison to the final one are not separately highlighted (e.g. supplementary budget). Such an additional column would make the Budget Execution Report longer, but the additional information it provided would be limited. Also, the budget of the expenditure transferred from the previous year can be found in the report for the previous year. This is why we have not considered the separate presentation of the budget transferred from the previous year to be necessary.</p> <p>The budget of the transferred expenditure is used up first of all, which is why we do not consider it necessary to distinguish the actual use of the budget of transferred expenditure. The budget transferred from the previous year was opened in the State Treasury just a couple of years ago (so-called source code 99), which is why it had to be separately used. This created additional technical work for accountants, but gave no added value in guaranteeing budget discipline. This is why the requirement to use the budget transferred from the previous year separately was abandoned last year.</p> <p>The recommendations of the National Audit Office have been largely considered since 2013 due to the amended structure of the State Budget Act. One of the goals of amending the structure of the State Budget Act was to plan a cash-based budget in such a manner that it would comply with the actual movement of money between agencies. Otherwise, guaranteeing control over the implementation of a cash-based budget would be impossible.</p>
<p><b>Transfer of state assets to RKAS</b></p> <p><b>50. Recommendations of the National Audit Office to the Minister of Finance:</b></p> <ul style="list-style-type: none"> <li>▪ explain in the Explanatory Memorandum of the 2014 Draft State Budget and in the State Budget Strategy to be submitted to the Riigikogu the length of time over which the increase in rent and lease expenses will be financed in the state budget and the activities of Riigi Kinnisvara AS in agreeing on rent and lease terms with the state will be</li> </ul>	<p><b>Response of the Minister of Finance:</b> We would like to point out that the rent expenses of state agencies before the transfer of assets to Riigi Kinnisvara AS (RKAS) are incomparable with the rent expenses that emerge after the transfer. Depreciation and other direct and indirect property management expenses were not recognised in rent expenses before the transfer of assets to RKAS, which the National Audit Office also noted in the draft. This means that the figures presented in the report as well as the performance ("This means that in the next four years, rent expenses will probably more than double") are based on incorrect assumptions and are therefore inadequate. We will submit the relevant explanations about the topic of rent prices in the explanatory</p>

Recommendations of the National Audit Office	Response of the Minister of Finance
<p>managed.</p> <ul style="list-style-type: none"> <li>▪ steer the activities of Riigi Kinnisvara AS in ordering property valuations from experts in such a manner that the substantive opinions of ministries regarding the intended use of the assets is considered as the basis of the valuations.</li> </ul> <p>(articles 40-49)</p>	<p>memorandum of the draft and in the budget strategy.</p> <p>Establishing a single set of rules for the state is one of the main tools for managing the expenses related to the properties of the state. This helps rent premises in a manner that is transparent and comparable, and to efficiently analyse used premises for making necessary management decisions. We are monitoring and analysing the market to see whether the rent requested by RKAS complies with market conditions and plan to continue this activity in future. This helps the state enter into thoroughly considered and practical lease contracts with RKAS.</p>
<p><b>Organisation of internal audit in the state</b></p> <p><b>68. Recommendation of the National Audit Office to the Minister of Finance:</b> organise regular meetings and training for internal auditors and help them share their experiences.</p> <p>(articles 62-67)</p>	<p><b>Response of the Minister of Finance:</b> We will consider the recommendations.</p>
<p><b>State forest accounting policies</b></p> <p><b>78. Recommendation of the National Audit Office to the Minister of Finance:</b> develop and establish new accounting policies for state forest which proceed from the nature of state forest and the asset as a whole.</p> <p>(articles 72-77)</p>	<p><b>Response of the Minister of Finance:</b> The proposal of the National Audit Office basically means returning to previous accounting policies and procedures. The opinion given in article 76 of the report that the accounting policy was changed because the value of the asset changed considerably in different years is not entirely correct. The main reason why the accounting policies were changed is that the formulas used according to the old accounting policies were extremely complicated and the results could not be checked (audited). Earlier calculations were based on the RITA database of the State Forest Management Centre. A large quantity of forest stands are recognised in this database. The data of each forest stand are changed about once every ten years as a result of stocktaking. The National Audit Office criticised the previous accounting methods and their implementation, and this criticism was thorough and justified. Implementation of new the accounting policies is much simpler and more understandable. According to the present accounting policies we recognise state forest in the balance sheet on the basis of the present value of the cash flow to be obtained from sales of forest in the future. We feel that the selected accounting policy is more suitable for state forest accounting than the previous accounting methods. The new accounting methods comply with international accounting standards, they are relatively easy to implement and their results are understandable. This is why do not intend to change the present accounting policy.</p>
<p><b>Centralisation of support services</b></p> <p><b>92. Recommendation of the National Audit Office to the Minister of Finance:</b> regularly assess the achievement of support service centralisation goals and the quality of the service, and organise an assessment of the impact of the activities of the State Shared Service Centre.</p> <p>(articles 82-91)</p>	<p><b>Response of the Minister of Finance:</b> Similar to the State Shared Service Centre (hereinafter the SSSC) the support service centralisation project has a documented action plan and we constantly monitor its performance. The most important goal is to provide quality support services to the agencies served. We regularly communicate with the agencies to assess this goal. We are also planning to carry out a customer satisfaction survey this year.</p>
<p><b>Related parties</b></p> <p><b>97. Recommendation of the National Audit Office to the Minister of Finance:</b> develop principles for collection of information about related parties and require state accounting entities to disclose this information in annual reports.</p> <p>(articles 93-96)</p>	<p><b>Response of the Minister of Finance:</b> We agree to discuss the principles of disclosure of information with state accounting entities and to consider the establishment of additional requirements on the basis of the results of the discussion.</p>

## Overview of the Consolidated Annual Report of the State

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.

The accounts of 17 state accounting entities with the agencies in their areas of government, the State Forest Management Centre, 64 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 226 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 (see Figure 1).

The Minister of Finance is 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.

**Figure 1. Entities consolidated in the Consolidated Annual Report of the State**

Consolidated financial statement of the public sector (additional information)			
Consolidated financial statement of the government sector (additional information)			
<b>Consolidated Annual Report of the State</b> State accounting entities (ministries with their areas of government, the State Chancellery and constitutional institutions) Profit-making state agency Public undertakings (companies) Foundation under the state's control	+ Local authorities	+ Legal entities in public law	+ Bank of Estonia Guarantee Fund Chamber of Notaries Estonian Board of Auditors

## Characteristics of the audit

### Reason 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 legality of transactions.

The objective of the audit is to express an opinion on the accuracy of the Consolidated Annual Accounts of the State for 2012 and the legality of transactions. The Annual Accounts of the State contain the balance sheet of consolidated and unconsolidated assets and liabilities as at 31.12.2012, the consolidated and unconsolidated income statement, report on changes in net assets and cash flow statement for the financial year ended on 31.12.2012, 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 an additional report.

### **Principles of expressing an opinion**

The opinion of the National Audit Office on the accuracy of the annual accounts of the state and the legality 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 2012 State Budget Act and the 2012 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 legality of transactions, but which could result in significant errors in the annual accounts or legality 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.

The report does not include minor errors whose impact is not significant. The attention of the auditees was brought to the need to eliminate such errors in the course of the relevant audits and in the memos sent to them.

### **Scope of audit**

In the course of giving an opinion on the accuracy of the state's 2012 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 Standards Board as well as the General Rules of State Accountancy.

In order to express an opinion on the legality of transactions, the National Audit Office audited whether or not the transactions of state agencies were performed in accordance with the State Budget Act, the 2012 State Budget Act and the 2012 State Budget Act Amendment Act in all material respects. For this purpose the National Audit Office focussed on the expediency and transparency of state budget implementation by checking the expedient use of the investments and labour 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 National Audit Office paid attention to adherence to the main principles of the Public Procurement Act and the State Assets Act when auditing legality. 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.

## Limitations 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 National Audit Office has not performed any additional audit activities in these entities. The National Audit Office considered the opinions of certified auditors when expressing its opinion of the annual accounts of the state. The certified auditors who gave their opinions of the annual accounts of foundations, companies and profit-making state agency did not assess the legality of their transactions. The opinions of the certified auditors of foundations controlled by the state and public undertakings are given in Notes 1 and 2.

The National Audit Office does not give an opinion on the management report presented as part of the Consolidated Annual Report of the State. The figures presented in the management report, which arise directly from the annual accounts, were checked.

The National Audit Office 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 National Audit Office performed the audit in accordance with the Audit Standards of the INSOSAI (International Organisation of Supreme Audit Institutions), which regulate auditing financial statements as well as the legality of transactions within the scope of auditing 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 about the figures presented and the information disclosed in the annual accounts as well as about the legality of transactions. To plan relevant audit operations, the National Audit Office took into account the internal audit system introduced to prepare true and fair annual accounts and to observe the legality of transactions without expressing an opinion on the efficiency of the internal audit. The relevance of the accounting principles and procedures used, the justification of the accounting assessments made by the management and the general manner of presentation of the annual accounts were also assessed in the course of the audit.

The National Audit Office is of the opinion that the audit provides a sufficient basis for expressing an opinion on the accuracy of the annual accounts and the legality of transactions.

## Time of completion of audit

The audit was completed in July 2013.

## Audit team

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

## Contact information

Further information on the audit is available from the Communication Service of the National Audit Office:

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An electronic copy of the audit report (pdf) is available online at [www.riigikontroll.ee](http://www.riigikontroll.ee).

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

The number of the audit report in the internal records system of the National Audit Office is 2-1.8/13/60065/37.

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

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

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

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

28.08.2009 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2008**

28.08.2008 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2007**

28.08.2007 – **National Audit Office report on the state's consolidated annual report 2006**

29.08.2006 – **National Audit Office report on the state's consolidated annual report 2005**

30.08.2005 – **National Audit Office report on the state's consolidated annual report 2004**

All reports are available on the website of the National Audit Office at [www.riigikontroll.ee](http://www.riigikontroll.ee).

## Note 1. Audit results of foundations controlled by the state

Foundation	Total assets as at 31.12.2012 (thousand euros)	Operating expenses 31.12.2012 (thousand euros)	Auditor's opinion
Innove Foundation	11,003	75,650	Unqualified opinion
Sports Training and Information Foundation	840	459	Unqualified opinion
Archimedes Foundation	85,965	127,563	Unqualified opinion
Estonian Science Foundation	8,515	18,364	Unqualified opinion
Estonian Qualifications Authority	319	985	Unqualified opinion
Tiger Leap Foundation	673	1,783	Unqualified opinion
AHHAA Science Centre	13,209	3,175	Unqualified opinion
Eesti Information Technology Foundation	8,552	7,914	Unqualified opinion
State Infocommunication Foundation	5,869	3,992	Unqualified opinion
SA KredEx	191,684	24,840	Unqualified opinion
Estonian Accreditation Centre	268	499	Unqualified opinion
Tallinn Science Park Tehnopol	14,362	3,243	Unqualified opinion
Enterprise Estonia	65,521	133,926	Unqualified opinion
Environmental Investment Centre	192,271	253,710	Unqualified opinion
National Foundation of Civil Society	1,543	1,743	Unqualified opinion
Tuuru SA	195	271	Unqualified opinion
Hiiumaa Hospital	2,485	1,761	Unqualified opinion
Jõgeva Hospital	1,786	3,470	Unqualified opinion
Jõgeva County Development and Enterprise Centre	63	156	Unqualified opinion
Koeru Care Centre	2,046	1,789	Unqualified opinion
AH Tammsaare Museum, Vargamäe	411	110	Unqualified opinion
Lääne County Development Centre	64	184	Unqualified opinion
Rapla County Development and Enterprise Centre	50	159	Unqualified opinion
Saaremaa Enterprise Promotion Foundation	56	175	Unqualified opinion
Viljandi County Development Centre	40	103	Unqualified opinion
Holstre-Polli Health Centre	1,522	270	Unqualified opinion
Võru County Development Agency	112	206	Unqualified opinion
Cultural Publications	605	1,985	Unqualified opinion
Tehvandi Sports Centre	18,704	2,590	Unqualified opinion
Estonian Song and Dance Celebration	1,003	1,325	Unqualified opinion
Integration and Migration Foundation Our People	2,971	4,089	Unqualified opinion
Estonian Drama Theatre	12,892	3,588	Unqualified opinion
Estonian Film Foundation	715	4,769	Unqualified opinion
Estonian National Museum Construction Foundation	0	36	Unqualified opinion
Museum Building Foundation	2,569	611	Unqualified opinion
Jõulumäe Recreation Centre	2,827	781	Unqualified opinion
Narva Aleksandri Church Foundation	697	34	Unqualified opinion
Rakvere Theatre House	4,428	2,093	Unqualified opinion
Tartu St John's Church Foundation	105	134	Unqualified opinion
Ugala Theatre	5,935	1,596	Unqualified opinion
UNESCO Estonian National Committee	22	124	Unqualified opinion
Old Town Theatre House Foundation	428	115	Unqualified opinion
Russian Theatre	12,173	1,773	Qualified opinion
Virumaa Museums	3,769	1,926	Unqualified opinion

Endla Theatre Foundation	3,620	1,738	Unqualified opinion
Theatre Vanemuine*	11,585	220	No annual report
Theatre NO99*	87	0	No annual report
Nuku Foundation*	443	0	No annual report
Narva Museum*	2,141	0	No annual report
Private Forest Centre	1,055	4,724	Unqualified opinion
University of Tartu Hospital	117,462	123,412	Unqualified opinion
Tartu Ambulance	2,529	5,381	Unqualified opinion
North Estonian Medical Centre	137,608	122,348	Unqualified opinion
Viljandi Hospital	10,958	13,878	Unqualified opinion
Haapsalu Neurological Rehabilitation Centre	3,869	2,844	Unqualified opinion
Estonian Health Image Database	1,159	647	Unqualified opinion
Estonian e-Health Foundation	2,598	2,505	Unqualified opinion
Sillamäe Drug Rehabilitation Centre	294	299	Unqualified opinion
Estonian Foundation for Disabled Persons	83	907	Unqualified opinion
Estonian Cooperation Assembly	21	259	Unqualified opinion
President of the Republic Cultural Foundation	17	43	Unqualified opinion
International Centre for Defence Studies	218	909	Unqualified opinion
Estonian Foreign Policy Institute	138	126	Unqualified opinion
Rural Development Foundation	46,422	2,667	Unqualified opinion

\* The foundations were established at the end of 2012 and annual reports were therefore not prepared.

Source: audited annual reports for 2012

## Note 2. Audit results of public undertakings

Undertaking	Holding (%)	Total assets as at 31.12.2012 (thousand euros)	Operating expenses 31.12.2012 (thousand euros)	Auditor's opinion
Riigi Kinnisvara AS	100	336,033	70,012	Unqualified opinion
Eesti Loto AS	100	10,338	36,232	Unqualified opinion
AS Levira	51	30,138	9,433	Unaudited as at year end*
Elering AS	100	515,729	68,192	Unqualified opinion
EVR Cargo AS	100	81,640	84,696	Unqualified opinion
Saarte Liinid AS	100	58,503	5,463	Unqualified opinion
Eesti Raudtee AS	100	248,529	60,233	Unqualified opinion
Eesti Post AS	100	46,631	50,339	Unqualified opinion
A.L.A.R.A AS	100	1,209	529	Unqualified opinion
Estonian Air AS	97.3	70,626	140,185	Disclaimer of opinion
Eesti Loots AS	100	17,537	6,651	Unqualified opinion
AS Eesti Vedelkütusevaru Agentuur	100	145,479	10,822	Unqualified opinion
Metrosert AS	100	1,579	1,908	Unqualified opinion
Tallinna Sadam AS	100	544,779	50,714	Qualified opinion
Eesti Energia AS	100	2,497,400	778,300	Unqualified opinion
Elektriraudtee AS	100	27,225	9,200	Unqualified opinion
Lennuliiklusteeninduse AS	100	25,996	12,448	Unqualified opinion
KredEx Krediidikindlustus AS	100	35,158	1,105	Unqualified opinion
Teede Tehnokeskus AS	100	2,385	2,446	Unqualified opinion
Tallinna Lennujaam AS	100	146,618	34,692	Unqualified opinion
AS Eesti Teed	100	23,119	25,517	Unqualified opinion
Andmevara AS	100	1,512	2,090	Unqualified opinion
State Forest Management Centre	100	1,199,482	115,346	Unqualified opinion
Eesti Geoloogiakeskus OÜ	100	1,257	1,458	Unqualified opinion
Eesti Kaardikeskus AS	100	452	513	Unqualified opinion
Eesti Keskkonnauuringute Keskus OÜ	100	5,039	5,360	Unqualified opinion
Ökosil AS	35	1,589	484	Unqualified opinion
AS Hoolekandeteenused	100	46,769	22,566	Unqualified opinion
Eesti Vanglatööstus AS	100	1,200	2,242	Unqualified opinion
AS Vireen	100	5,190	2,346	Unqualified opinion
AS Eesti Metsataim	69.9	3,194	753	Unqualified opinion

\* The financial year of AS Levira starts on 1 April 2012 and ends on 31 March 2013.

Source: audited annual reports for 2012