Auditor's Report

24.05.2002 nr 2-5/02/3

Auditor's Report of the State Audit Office on the financial statements for 2001 of the Baltic Defence College

[Unofficial translation from Estonian original]

Tallinn
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Introduction

In accordance with the audit plan of the year 2002 of the *Riigikontroll* (the State Audit Office), we have completed our audit of economic activities of the Baltic Defence College (hereinafter "the College") for the year 2001. Our audit was conducted in the period from February 18 to March 15, 2002.

We have audited the financial statements of the College, for year ended 31.12.2001[1]. The principles of financing, accounting and auditing of the College are stipulated in the Memorandum of Understanding[2] (hereinafter: "the Memorandum"). Proceeding from the latter, the College conducts its accounting in accordance with the legislation of the Republic of Estonia (the hosting participant), which is specified and supplemented by regulations concerning financial and accounting matters approved by the Board of the College.

In organising its accounting and preparation of the financial statements, the College (on the basis of recommendations of the Ministries of Finance and Defence) has proceeded from the legislation, which regulates the accounting and reporting in the public sector of the Republic of Estonia[3]. In our view there is a continual lack of provisions defining the principles of accounting and reporting, on which the College should base its financial statements.

The audit team was headed by Audit Manager of the Financial Audit Department Tõnis Saar, the team comprised Auditor Merike Starovoitov and Senior Auditor Õie Soovik.

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[1] The report is available at the homepage of the State Audit Office http://www.riigikontroll.ee.

[2] The Memorandum of Understanding on cooperation regarding the founding, activity, management, initial financing and travel of staff of the Baltic Defence College located in the Republic of Estonia, concluded between the Minister of Defence of the Republic of Estonia, the Minister of Defence of the Republic of Latvia, the Minister of Defence of the Republic of Lithuania, the Minister of Defence of the Kingdom of Denmark, the Minister of Defence of the Republic of Finland, the Minister of Defence of the Federal Republic of Germany, the Minister of Defence of the Kingdom of the Netherlands, the Minister of Defence of the Kingdom of Norway, the Minister of Defence of the Republic of Poland, the Minister of Defence of the Kingdom of Sweden, the Minister of Defence of the Confederation of Switzerland and the Minister of Defence of the United Kingdom of Great Britain and Northern Ireland.

[3] Regulation of the Minister of Finance no. 105 of 06.12.2001.

1. Bases for the formulation of the opinion

1.1. Mandate of the State Audit Office

The Swedish National Audit Office performed the auditing of the financial activities of the College in 2000, because Sweden was the presiding country in the given project. As a result of gradual changing of the financing scheme of the College, the financing of the budget currently covered by the supporting participants will be transferred to the three Baltic states, therefore the supporting participants see the auditing of the College as an obligation of Estonia. The Minister of Defence of the Republic of Estonia has made a respective proposal to the State Audit Office[4] on which we have based this audit.

1.2. The purpose of the audit

The purpose of the audit is to give an opinion on the financial statements of the College for 2001. The opinion is formulated on the basis of the following criteria:

- Whether financial transactions have been recorded in substance and arithmetically correctly
- Whether the assets are actually owned by the organisation and whether the debts are actually its liabilities
- Whether the assets and liabilities exist in reality
- Whether the assets and liabilities have been appropriately assessed
- Whether the incomes and expenses are recorded on accrual basis, in the correct period and in full extent
- Whether the accounting system of the organisation corresponds to the requirements set by the Accounting Law and the regulations of the Minister of Finance and generally accepted accounting principles, in an extent applicable to the institutions of the public sector of the Republic of Estonia.

The purpose of the audit is also to give an opinion on whether in incurring expenditure the College has proceeded from the budget approved by its Board[5]. Because the budget approved by the Board has not been submitted to us, we cannot give an opinion on that.

As a result of the audit we do not give an overall opinion on the financial management, but we present main observations and shortcomings detected during the audit.

1.3. Compliance to standards

We conducted the audit in accordance with the auditing standards of INTOSAI[6]. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence

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[4] Letter of the Minister of Defence no. 1-430/5629 of 11.01.2000.
[5] As stipulated in the Memorandum (Annex C, clause 3), the detailed budget of the College must be adopted by the Board of the College.
[6] INTOSAI - International Organisation of Supreme Audit Institutions acting under the auspices of the UN.

supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management. We believe that our audit provides a reasonable basis for our opinion on the financial statements.

1.4. Responsibility for the correctness of the financial statements

The head of the College and the person responsible for accounting are responsible for the preparation of the financial statements and correctness of the information contained therein.

2. Opinion on the financial statements for 2001 of the Baltic Defence College

2.1. In the course of the audit we have made the following qualifications regarding the financial statements for 2001 of the Baltic Defence College:

2.1.1. The books have been recorded in the fixed assets as one amount of 1 056 822 kroons. As the accounting of the College does not include a list of what the above balance consists of, we are not able to evaluate the correctness of this balance.

2.1.2. Resources allocated to the College by supporting participants are recorded upon receipt as revenue. When assessments from supporting participants are used to acquire fixed assets, then, in accordance with the Regulation of the Minister of Finance no. 105 § 3 of 06.12.2001, the book value of fixed assets acquired, must be recorded in the balance sheet in long-term provisions. Assessments are entered as revenue proportionally with depreciation. For example, the book value of computers acquired for resources allocated by the French Embassy in amount of 357 458 kroons has not been recorded in the balance sheet as a long-term provision. As there is no relevant accounting, we are not able to evaluate the total amount of the misstatement.

2.1.3. When the supporting participants have subsequently compensated expenditure incurred, the amount of expenses has been decreased on the basis of the invoice served. It is not permissible to offset expenditures by revenues and vice versa. The revenues and expenditures of the College have been recorded in the statements as decreased by 377 630 kroons.

2.1.4. Proceeding from the Memorandum (Annex C, clause 8), the College is responsible for establishment and maintaining a table of equipments stating ownership of all resources. Such an accounting was not submitted to us. As the accounting is lacking, we have no information on the amount and ownership of the assets used by the College.

2.2. Opinion of the State Audit Office

In our opinion, considering the extent of the audit and excluding the possible influence of the circumstances described in clauses 2.1.1.-2.1.4., the above mentioned financial statements as of 31.12.2001, showing the revenue of the year 2001 in amount of 1 893 102 kroons and the balance sheet volume as of 31.12.2001 of 7 436 152 kroons, is drawn up in all material respects in accordance with the Regulation of the Minister of Finance of the Republic of Estonia no. 105 of 06.12.2001 "With regard to compilation, submission and approval of the financial statements of year 2001".

2.3. Recommendations

2.3.1 We recommend to compile a list of the books recorded in the balance sheet, indicating the acquisition cost, acquisition time and acquisition source.

2.3.2 A list should be compiled of all fixed assets acquired on account of supporting participants assessments. In the balance sheet, the revenues, expenses and the balance of long-term provisions for the respective period should be adjusted by the acquisition cost and depreciation

of such fixed assets, so that the long-term provisions would reflect the book value of these fixed assets for the period.

2.3.3 It is not permissible to offset revenues by expenses and vice versa. We recommend to record all invoices served by the College as revenues and all invoices received by the College as Expenses.

2.3.4 According to clause 8 of Annex C of the Memorandum, a list of all assets at the disposal of the College is to be compiled.

3. Observations regarding financial management

3.1. Without giving an opinion on the financial management, we present the following observations:

3.1.1 The above mentioned statements do not cover all assets, liabilities, incomes and expenses of the Baltic Defence College. The statements record the use of contributions and other subsidies of the founder states (Denmark, Switzerland, Sweden, Norway, Iceland, Finland, the Netherlands), but do not reflect the resources allocated for the activity of the College by the three Baltic states. Separate accounts are kept for the use of resources from the state budget of the Republic of Estonia and the separate financial statements are compiled for these resources. According to the unaudited data, 4 572 575 kroons were allocated to the Baltic Defence College from the state budget for 2001 of the Republic of Estonia. As of 31.12.2001, the total balance sheet of the Republic of Estonia shows the assets of the College in amount of 856 717 kroons and the revenue of 856 353 kroons. In our opinion the recording of the economic activity of the College in separate financial statements does not give an overall view of the activity of this educational institution, its assets nor the necessary expenses for the maintenance of the College.

3.1.2 During the audit the budget approved by the Board of the College[7] was not submitted to us and thus we are not able to evaluate, whether the College has proceeded from the budget when incurring its expenses.

3.1.3 The accounting procedures documentation of the College for 2001 was approved with retrospective effect on February 15, 2002 by the head of the institution. We draw attention to the fact that as per the Memorandum (Annex C, clause 2, sub clause F) this is the mandate of the Board. The Board has not approved the accounting procedures documentation.

3.1.4 According to the accounting procedures documentation approved by the head of the institution, the College, in the organisation of its accounting, must proceed from the Accounting Law of the Republic of Estonia, Standards and Pronouncements of Estonian Accounting Standards Board and international accounting standards. Actually the accounting has been based on the legislation regulating accounting and reporting in the public sector of the Republic of Estonia[8].

3.2 Recommendations

3.2.1 We recommend to record the whole economic activity of the College in one financial statements to ensure a overall view of the activity of institution, its assets and the expenses necessary for maintenance of the College. If it is needed (to meet the supporting participants needs) we encourage considering the separate reporting for each supporting country.

3.2.2 In view of the provisions of the Memorandum, we recommend that the Board should approve the budget of the College.

3.2.3 We recommend to stipulate in the accounting procedures documentation, whether the preparation of financial statements is based on the legislation of the Republic of Estonia

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[7] As stipulated in the Memorandum (Annex C, clause 3), the detailed budget of the College must be adopted by the Board of the College.

[8] Regulation of the Minister of Finance no. 105 of 06.12.2001.

applicable to public sector institutions or the legislation applicable to private sector institutions. It is in the competence of the Board to approve the accounting principles.

4. Position of the auditee

Jana Lundblad as representative of the College, has given her comments to this report as follows[9]:

- Recommendation 2.3.1. Agrees with the recommendation. The list concerning the books exists since 2002.
- Recommendation 2.3.2. Agrees with the recommendation. It is not necessary to compile a separate list of fixed assets.
- Recommendation 2.3.3. Agrees with the recommendation. College has followed this recommendation since 2002.
- Recommendation 2.3.4. Does not agree with the recommendation, because College has no assets described in clause 8 of Annex C of the Memorandum.
- Observation 3.1.1. Agrees, but finds, that she as the representative of the College is not authorized to modify the accounting system.
- Observation 3.1.2. Agrees.
- Observation 3.1.3. Agrees, referring that the accounting procedures documentation has been submitted to the Board of the Baltic Defence College for adoption.
- Recommendation 3.2.3. Does not agree with the recommendation and adds, that it is not possible exhaustively to stipulate in the accounting procedures, on the basis of which law or regulation the annual report is prepared. As the College is the unique institution the Chief Accountant prepares the annual report in accordance with the provisions of the Accounting Law and at her better discretion.

[9] Full text of the comments (unnofficial translation from Estonian original) is added to the report

5. The State Audit Office Response for the position of the auditee

- Recommendation 2.3.4. According to the explanation given to us, College uses the assets which are owned by the either Baltic- or supporting participant. For example the following assets are owned by the Ministry of Defence of the Estonian Republic and used by the College:
  - BMW 520, registration number 171 EKV
  - Opel Omega, registration number 173 EKV
  - VW Transporter, registration number 180 EKV
  - BMW 520, registration number 200 EKV
  - BMW 520, registration number 172 EKV

  According to the sub clause (d) clause 8 of Annex C of the memorandum these assets will not be included in the accounts of College, but according to the sub clause (e) the College is responsible for establishing and maintaining the Table of Equipment, stating the ownership of all resources.

- Recommendation 3.2.3. The State Audit Office has taken the obligation to give an opinion on the College financial statements. If College is not going to define which Estonian accounting principles and legislation they are following or will prepare the report according to controversial legislation and therefore will not follow them completely, than we cannot give an opinion of the correctness of the financial statements.

/Signature/

Kaie Karniol
Chief Auditor
Financial Audit Department

[Unofficial translation from Estonian original]

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Ms Kaie Karniol
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Financial Audit Department

Our ref. 21.05.2002, no. 6.5.0/1304

Reply to your letter of 17.05.2002 no. 2-7, 1-FA/02/627-1

I hereby present our positions and opinions, commenting on the issues mentioned in your letter in the order of their presentation.

2.3.1.
A list concerning the books recorded as fixed assets exists in the accounting department since 2002, indicating their acquisition cost and acquisition source. The acquisition times for all the books acquired earlier are indicated on the dispatch notes of the books.

2.3.2.
We do not agree that there is a need to compile a separate list of the fixed assets of the College acquired on account of supporting participants assessments. All fixed assets have been acquired on account of assessments, because the Baltic Defence College as such is based on supporting participants assessments.

2.3.3.
We have followed this recommendation since 2002, although this is in contravention of the opinion of the financial controllers of the Kingdom of Sweden working for the Baltic Defence College.

2.3.4.
The Baltic Defence College has no assets described in clause 8 of Annex C of the Memorandum. Thus we are not able to submit the respective list.

3.1.1.
Commenting on your opinion set forth in the clause indicated, I am, as a representative of the College, not authorised to modify the accounting system agreed on before the founding of the College. At the same time I share your position that the amounts allocated to the Baltic Defence College by the Estonian Government should be reflected in common accounting system, i.e. the accounts of the Baltic Defence College.

3.1.2.
No original documents on the budget (2001) have been submitted to the accounting department. In incurring expenditure, we have proceeded from the budget received from the Board of the Baltic Defence College by electronic mail.

3.1.3.
The accounting procedures documentation has been submitted to the Board of the Baltic Defence College for adoption.

3.2.3.
It is not possible exhaustively to stipulate in the accounting procedures, on the basis of which law or regulation the annual report is prepared. This is caused by the fact that the College is a unique institution where it is not possible to follow any one and only law in the organisation of accounting. Therefore the Chief Accountant prepares the annual report in accordance with the provisions of the Accounting Law and at her better discretion.

/signature/
Jana Lundblad
Chief Accountant