Formation, replenishment and preservation of the national stockpile of grains

Audit Report

Executive Summary

The State Audit Office audited the formation, storage and replenishment of the national stockpile of grains from 1 January 2002 until 30 April 2004, focusing on the existence of a legal regulation, the adherence to legislation, the compliance with agreements, the lawfulness of transactions conducted for the purpose of replenishment of the security stockpile, the preservation of the security stockpile, the lawfulness and purposefulness of spending the funds that have been allocated from the state budget, the organisation and reliability of accounting and reporting (incl. concerning bookkeeping) and the functioning of internal audit systems.

The National Stockpiles Act regulates issues relating to national stockpiles and determines the Ministries in charge of the national stockpiles. The Ministry of Agriculture organises the administration of the security stockpile of foodstuffs, incl. grains. For storage of grains the Ministry of Agriculture has entered into a commission and storage agreement with AS Eesti Viljasalv. In the audited period AS Eesti Viljasalv authorised the storage of the security stockpile of grains to nine companies specialised in the storage of grains with which storage agreements were signed.

Funds are allocated to the Ministry of Agriculture for formation, storage and replenishment of the security stockpile of grains from the state budget. For formation of the security stockpile, 21 million kroons was used in the year 2002 and 8.5 million kroons was used in the year 2003. For replenishment of the security stockpile, grains were sold for 22.3 million kroons in the year 2002 and for 34.9 million kroons in the year 2003. For storage of the stockpile of grains, 9.6 million kroons was spent in 2002, 8.6 million kroons in 2003 and 1.6 million kroons in the first four months of the year 2004.

The Government of the Republic, the Ministry of Agriculture and AS Eesti Viljasalv failed to ensure the preservation of the security stockpile of grains. In years 2003 and 2004, grains were lost from the security stockpile as follows: 14,079 tons of grains worth 26.6 million kroons in AS Rakvere Viljasalv, 362.7 tons of grains worth 725,400 kroons in AS Tamsalu Veskid, and 481.5 tons worth 626,004 kroons in AS Jõgeva Viljasalv.

Main findings

- The National Stockpiles Act is completely outdated by now, because the principles and ideology of the Act fail to reflect the current situation (in particular in light of Estonia's accession to the European Union and NATO). Resources kept as the national stockpile do not comply with current security needs. The adoption of a new Act would require the development of a general conception of security stockpiles. Tasks provided for in the Emergency Preparedness Act have not been fully complied with – the state has not performed the assessment of risks. In addition, the State Audit Office lacks any data evidencing that Ministries have performed risk assessments and prepared crisis management plans on the basis of the assessments. Therefore, it is unclear as to what the security stockpile should consist of (assortment, quantities).

- The provisions of the State Secrets Act and the National Stockpiles Act, which regulate the classification of the security stockpile, are in conflict with each other. Pursuant to the State Secrets Act (§ 6 5)), the list and quantities of the security stockpile constitute state secrets classified as "secret." However, the National Stockpiles Act (§ 141) establishes that the quantities and location of the security stockpile are classified as secret, whereas the list is not classified. The Ministry of Agriculture, AS Eesti Viljasalv and depositaries of the security stockpile of grains have failed to fully adhere to the requirement established in the State Secrets Act with regard to the classification of the quantities and location of the security stockpile.

- Ignoring the provisions of the National Stockpiles Act, the Government of the Republic has failed to approve the composition and assortment, minimum and maximum amounts and term of formation of the security stockpile. According to the explanation of the Minister of Agriculture, he had submitted relevant proposals to the State Chancellery in 1999, but the Government of the Republic did not approve those proposals. Hence, the State Audit Office does not understand

which criteria the Government of the Republic, the Ministry of Finance and the Ministry of Agriculture guided themselves by in planning funds for purchase of grains for the security stockpile of grains in the state budget. According to the Statutes of the State Chancellery, the State Chancellery should have supervised the performance of the obligations established in the National Stockpiles Act and forwarded the relevant proposals to the Government of the Republic.

- The Ministry of Agriculture and AS Eesti Viljasalv have failed to adequately take into account risks in depositing the security stockpile. The Ministry and AS Eesti Viljasalv have made an agreement under which the company is entitled to enter into so-called sub-storage agreements for storage of food grains with persons who own storage areas (grains elevators and granaries). The Ministry of Agriculture lacks an overview of these agreements. The reliability and financial capacity of companies storing the grains has not been verified. Storage of a large stockpile in one location entails additional risks. For example, as of the end of the year 2003, 14,428 tons of grains in the security stockpile had been deposited with AS Rakvere Viljasalv, which accounts for a major part of the entire grain stockpile. Four elevators accommodated more than 80% of the national stockpile of grains.

- The purchase of grains for the security stockpile complied with the requirements established by the Minister of Agriculture. On the other hand, the Minister had established the maximum purchase price of grains at a level which was 25% higher than the market prices of grains in the Estonian grains market. Employees of AS Eesti Viljasalv explained that the higher purchase price had been reasoned by support to grains production in Estonia. The State Audit Office deems it inappropriate to support agriculture through higher purchase prices, because support is provided by means of direct aid from the state budget. According to the calculations performed by the State Audit Office, in 2002–2003 grains had been sold at prices lower than the acquisition cost by a total of 17.9 million kroons. Since the purchase prices were constantly higher than the selling prices, the cost of inventories in the Balance Sheet was overvalued, as well. The State Audit Office has highlighted that shortcoming in the course of its earlier audits, but the cost of inventories has not been adjusted.

- The sales of grains organised by AS Eesti Viljasalv is neither traceable nor transparent. Agreements have been made with buyers of food grains, where the quantities and locations of the grains to be bought were specified. Under these agreements, the Director of AS Eesti Viljasalv prepared orders for an issuance of grains, which did not conform to the data specified in the agreements, as a rule. AS Eesti Viljasalv violated the requirements established on the procedure for sales and consented to the assignment of the right of purchase to companies that had not participated in the selling auction. The effective procedure for sales lacks provisions concerning the assignment of the purchase right, the cancellation of agreements, and the change of contractual quantities and place of issuance; furthermore, it is unclear how to behave in the situation where the quantities of food grains issued from the national stockpile fall short of or exceed the promised quantities. The Ministry of Agriculture has not verified or analysed the activity of AS Eesti Viljasalv in selling grains for the purpose of replenishment of the security stockpile of food grains. The audit revealed that AS Rakvere Viljasalv has failed to discharge its contractual obligations since the year 2002. Nevertheless, AS Eesti Viljasalv has not clarified the situation or imposed any sanctions. AS Eesti Viljasalv has failed to abide by the requirements established in the procedure for sales, wherefore during the audited period penalties to the amount 1,000,000 kroons was not collected for failure to observe the terms and conditions of agreements (in the agreements the penalties were defined as caution money).

- The Ministry of Agriculture made an unjustified prepayment, transferring 5 million kroons to AS Eesti Viljasalv as a cover for expenses to be incurred in the forthcoming years. AS Eesti Viljasalv failed to abide by the conditions of use of the money as prescribed by the Ministry. However, the Ministry of Agriculture did not verify the compliance with its orders either. AS Eesti Viljasalv issued loans to companies to ensure the purchase of food grains, but the borrowers failed to abide by the terms and conditions of loan agreements. Nevertheless, AS Eesti Viljasalv did not guide itself by the interest rate prescribed in the agreements and therefore failed to collect the interest of 40,254 kroons. In violation of the agreement, AS Eesti Viljasalv placed funds, which it had received from the state as an advance payment, in overnight deposits and earned a total of 101,605 kroons on these funds. The State Audit Office is of the opinion that both the interest earned on overnight deposits and the interest to be collected on the loans granted out of the state budget funds should be transferred to the state budget.

- The Ministry of Agriculture and AS Eesti Viljasalv failed to ensure the preservation of the security stockpile of grains. The Supervisory Board of AS Eesti Viljasalv did not verify whether the Management Board of AS Eesti Viljasalv has ensured the preservation of the security stockpile of grains. The Supervisory Board failed to discuss many important issues, such as the development of a methodology for carrying out the stocktaking of grains, the reliability of stocktaking, the

selection of depositaries of grains and verification of their dependability. Annual stocktaking had been carried out in a superficial manner. Documents of AS Rakvere Viljasalv allow the conclusion that a material shortage was ascertained in the security stockpile of grains at the date of the annual stocktaking in both 2002 and 2003, which was not detected in the course of regular stocktaking. Inadequate inspection measures contributed to the occurrence of the shortage.

- In the accounting of AS Rakvere Viljasalv the balances of commercial grains were recorded with a minus, i.e. as a shortage in some periods. At the same time, incoming grains were recorded, but this was not certified by source documents. This allows the State Audit Office to conclude that the received grains that were not certified by source documents belonged among the national stockpile that AS Rakvere Viljasalv used for unauthorised commercial activity.

- Shortcomings were ascertained in the accounting and reporting of the security stockpile of grains. The Ministry of Agriculture lacked an overview of the quantities of the security stockpile of grains, broken down by depositaries of the stockpile. The accounting policies and procedures of AS Eesti Viljasalv do not regulate the disclosure of transactions relating to the national stockpile, which is in conflict with the requirements established in the Accounting Act. AS Eesti Viljasalv has not developed uniform requirements on stock accounting for all depositaries of the national security stockpile of grains in order to ensure an integrated overview of the national security stockpile of grains. The relevant employees of AS Eesti Viljasalv have not required the submission of bills of delivery in order to verify compliance with the orders of the Director of AS Eesti Viljasalv concerning the issuance of grains from the national stockpile and the delivery of the grains to buyers.

Main proposals

To the Government of the Republic, for arranging the national stockpiles system and for ensuring the preservation of the security stockpile:

- To prepare legislation regulating the security stockpile on the basis of the prognosis of hazards and to regulate the possibilities of prompt management of security stockpiles in legislation (regulations, quantities, locations, lists).

- To consider termination of storage of the security stockpile of grains and replacement of the security stockpile with an operation stockpile for which agreements could be made with producers and remuneration could be paid for maintaining the stockpile.

- If it is decided to keep the security stockpile, the composition and assortment, minimum and maximum quantities and terms of formation of the security stockpile of grains must be approved, whereas the financing of the security stockpile must be based on the norms so approved.

- If it is decided to terminate the use of an intermediary for keeping the security stockpile of food grains (AS Eesti Viljasalv), the liquidation of the activities of AS Eesti Viljasalv and the dissolution of the company should be considered.

- When elaborating a new National Stockpiles Act, the requirements on storage of the stockpiles must be preserved while considering the specific features of each stockpile type (medicinal products, grains, foodstuffs, etc.) and the following aspects:

    - storage conditions, and an analysis of the financial means necessary for abiding by these conditions;
    - the procedure for and methodology of stocktaking (thereby different methodologies should be analysed and the most appropriate methodology should be selected with the help of experts);
    - stocktaking of specific stockpiles (grains) in conjunction with experts;

- To evaluate the compliance of stockpiles with the current requirements on storage; to prescribe an action plan stipulating the term and manner of, and means necessary for, ensuring compliance with the requirements.

- To consider minimising the classification of the security stockpile and to prescribe classification only in the case of a justified need.

To the Minister of Finance, for intensification of supervision over the security stockpile:

- To oblige the Financial Control Department of the Ministry of Finance to observe and analyse risk assessments prepared by the internal auditors of relevant Ministries with regard to security stockpiles and to provide the internal auditors with methodological assistance in supervising the preservation of security stockpiles. To conduct audits on the part of the Ministry, if necessary.

To the Minister of Agriculture, for arranging the security stockpile:

- To consider the need to terminate the use of an intermediary for keeping the security stockpile of food grains (AS Eesti Viljasalv) and to decide whether it would be more rational for the Ministry of Agriculture to directly deal with the security stockpile of foodstuffs (i.e. purchase and sales of foodstuffs, entry into agreements with depositaries of foodstuffs, etc.).

In order to improve the administration of the security stockpile as regards the formation and replenishment of the national stockpile of grains:

- When buying grains for the security stockpile, to take guidance from market prices.
- For replenishment of the security stockpile, to develop a detailed procedure for sales of grains and to organise continuous analysis of and supervision over the compliance with that procedure.
- To collect the penalty of 1,000,000 kroons (the caution money) from AS Eesti Viljasalv and to transfer it to the state budget.
- To precisely stipulate the reasons for extraordinary (i.e. before the third year of storage of grains) replenishment of the national stockpile in the procedure for sales established by the Ministry.
- To reclaim from AS Eesti Viljasalv the unused advance payment of 409,402 kroons, as well as the interest of 101,605 kroons earned on the money allocated by the state, and to transfer these sums to the state budget.
- To collect the interest of 40,254 kroons from AS Eesti Viljasalv which the latter failed to collect on the loans issued to companies for securing the purchase of food grains, and to transfer the interest to the state budget.

For securing the preservation of the security stockpile:

- To analyse the risks entailed by the accumulation of the grain stockpile with one depositary and to forward suggestions for hedging the risks to the Supervisory Board and Management Board of AS Eesti Viljasalv.
- To constantly monitor the financial status of the depositaries of the security stockpile (tax arrears, assumption of large loan obligations and other obligations, etc.).
- To develop a detailed procedure (regulations) for carrying out the stocktaking of the stockpile of grains, indicating the methodology of stocktaking aiming at detecting any hidden deficit of grains.
- To take unexpected extraordinary inventories of the stockpile each year.
- To consider whether it would be rational to keep security stockpiles of foodstuffs in sealed depositories or employ other technological options (e.g. the introduction of an electronic surveillance system, etc.).

In order to arrange the reporting and accounting of the security stockpile of food grains and to improve supervision:

- To develop a system for supervision of the security stockpile of foodstuffs, incl.
    - to analyse risk assessments;
    - to direct the activity of the Supervisory Board of AS Eesti Viljasalv aiming at ensuring the preservation of the security stockpile;
    - to improve the cooperation of the Ministry's structural units in inspecting the security stockpile;
    - to establish the methodology and procedure for inspection of the security stockpile;
    - to designate persons responsible for the functioning of the security stockpile supervision system;
    - to initiate a departmental investigation to ascertain the officials at fault and to bring them to justice;

    - to consider the imposition of joint and several liability under section 327 of the Commercial Code on the members of the Supervisory Board of AS Eesti Viljasalv for the causation of substantial proprietary damage to the state by non-performance of their supervisory obligations.

- the management of AS Eesti Viljasalv must be required to submit periodic (at least once a quarter) overviews of transactions involving the security stockpile and of the measures employed to ensure the preservation of the security stockpile; the Minister of Agriculture must immediately be informed of all circumstances and risks that might jeopardise the preservation of the security stockpile;
- draft storage agreements must be reviewed and the management must be required to submit information on the reliability of depositaries on a regular basis.

The full text of the Audit Report is not published, as it contains state secrets.

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