Business activities of AS Saarte Liinid

Audit report no. 2-5/04/21 of April 8, 2004

Executive summary

The State Audit Office carried out an audit of the business activities of AS Saarte Liinid during the period from January 1, 2002 to October 1, 2003, focusing on the lawfulness of its economic transactions, the accounting and report system, and the effectiveness of internal control systems.

The main activity of the publicly owned company AS Saarte Liinid is the management of the harbours of West-Estonian mainland and islands, and rendering harbour services. The main purpose of the company is the servicing of ferry transportation at the best possible level and ensuring the safety, comfort and the maximum amount of services for the passengers, vehicles and vessels, as well as meeting of the environmental security requirements of the harbours. The company plays an important part in the government's regional policy. In 2002 and 2003 AS Saarte Liinid received 17.5 million and 15 million EEK, respectively, from the state budget,

Main findings

The accounting system of the company has been faulty and contains breaches of the Accounting Act, good accounting practices and the internal rules of the company accounting. The main reason for the problems may be the fact that the accounting of the company is divided between several structural units.

- In many cases, while taking inventory of real estate, the cost of land, structures and buildings were not separated. The depreciable assets have different duration of use, whereas the acquisition cost of land, which is an asset with unlimited duration of use, is not subject to depreciation. This is why the failure to correctly separate the acquired assets has led to grave depreciation errors. For instance, depreciation worth EEK 141,000 has not been accounted for within the property of the Ringsu harbour, while excess depreciation of the guesthouse of the Roomassaare harbour has been documented.
- In many cases, operation costs have been amended in the accounting records without appending the requisite documentation. This diminishes the transparency of accounting and does not bring out errors in good time.
- The reconstruction of the southern quay of the Ringsu harbour (EEK 820,973) and the dredging of the Triigi harbour (EEK 2,103,099) have been recorded under unfinished building projects. The work has been completed and approved by a committee but at the time of the audit both sites were still unrecorded as fixed assets. This should have been done immediately upon the completion of the builders' work in order to start the accounting of depreciation.
- The harbour fees of the ferries were recorded in the central office upon the issue of the invoices and were divided between individual outfits at the end of the month. However, the bases of division of income were nowhere stated in a documented from. Proportionately with the previous year's income of individual harbours the general expenditure of the central office was divided between the expenditure of individual harbours (the percentage of the division the same each month) as the operator's general expenditure (remuneration etc.). The SAO considers such division of income and expenditure unpractical because it increases the volume of accounting; it makes the situation more complicated for the user of accounting information and raises the probability of errors. This method of accounting was reportedly employed because of the need to report the profit of individual harbours. In the opinion of the SAO the division of income and expenditure between individual outfits can be done outside of the accounting programmes with the view of using this information in financial management.
- Individual harbours and the central office handled the accounting of remuneration, incl. taxes, differently. Such a system is difficult to inspect and it creates possibilities for inadvertent errors, causing taxation risks.

The internal rules regulating various procedures are in need of substantial supplementation. The SAO found omissions in the accounting rules; several necessary regulations are missing altogether, which leads to operational risks.

- The company had no regulations for the granting of use of its assets. Although the adMinistrative practice had established the separation of the initiator and performer of lease transactions, there was no obligation of analysis of the economic justification of the lease of the assets. Only 11 per cent of the leases have been concluded via public tenders.
- Likewise, there were no regulations for the business travel providing for the internal procedures and taking into account the regulations established by the Government of the Republic.
- There were no rules regulating the competence of the Supervisory Board and the Management Board in the budgeting process, the level of budgeting details approved by the Supervisory Board, the stages and deadlines of the budgeting process and the inspection procedures (reporting, etc.) over the implementation of the budget.
- During the period of carrying out the audit, the company had no public procurement guidelines corresponding to the specifics of its business activities; the general principles of building activities were dated and not sufficiently tied in with requirements of the Public Procurement Act: the tasks and responsibilities of the organizers of the procurements were not clearly stated nor the justification of the procurements required.
- Just as important as the various regulations, are the documents describing the employees' tasks. The Supervisory Board had concluded an contract of service with only the Chairman of the Board.

The State Audit Office also detected cases of unreasonable financial management.

- Among the unfinished building projects there were some that had been abandoned for longer periods of time, for instance the unfinished Rohuküla northern harbour quay (EEK 6.7 million, whereof EEK 5.1 million was received from the Tallinn Port already in 1994). Within the unfinished building projects, the volume of designing has been continuously increasing, which leads to the conclusion that part of the designs are now dated and will never be used. During the audited period, the Supervisory Board and the Management Board did not analyse the need for completing the abandoned building projects.
- Some leaseholders have not paid rent to the company according to the conditions provided in the lease. The Management Board has not applied the sanctions arising from the leases after the deadlines were ignored. This is why during the audited period, over 30.500 EEK of income from forfeit penalties was not collected.
- The SAO found that the conditions for leasing the advertising spaces were not sufficiently clear, considering that the main purpose of the company is to earn a profit.
- The Supervisory Board included the reconstruction of the Triigi harbour in the investment plan of the company, gave the Management Board the permission of concluding a usufruct contract for the property of the Triigi harbour and incur expenses on the harbour structures according to the intentions record prior to the conclusion of the usufruct contract. The harbour is subject to usufruct of the AS Saarte Liinid for 7 years. According to the company analysis, EEK 9.2 million will be invested in the harbour during the 7 years, earning EEK 5.32 millions of income. In the opinion of SAO, the expenditure made on procurements for the reconstruction of the Triigi harbour (EEK 4.3 million) were unpractical from the point of view of the company.
- The sums amounting to thousands of kroons, for which legal services of undefined content and volume were bought, are also noteworthy. When buying legal advice, a contract should be concluded stating the content and approximate cost of the lawyer's service. The same level of details should be followed on the invoice presented for the actual work.

Main proposals

To the Minister of Economic Affairs and Communications

- In order to avoid a great loss for the company, the Minister of Economic Affairs and Communications should express an opinion whether AS Saarte Liinid, taking upon itself the reconstruction of the Triigi Harbour, was actually subsidising the local government without knowing what will become of the project after the investment of millions of kroons and the end of the duration of usufruct.

To the Supervisory Board of AS Saarte Liinid

- Conclude a contract of service with all the Management Board Members of the company based on the Law of Obligations Act, which would define the tasks and responsibilities of the said Members.
- Improve supervision over the use of fixed assets.

To the Management Board of AS Saarte Liinid

- Consider concentrating the accounting into the central office in order to diminish the risk of errors arising from different accounting principles and to facilitate the inspection of the accounting.
- Supplement the internal rules of accounting and adopt the regulations for the granting of use of the fixed assets, the business travel, the regulation of budgeting process and use of client cards.
- In order to improve the arrangement of public procurements, approve the corresponding guidelines based on the Public Procurement Act and the specifics of the activities of the company.

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The Minister of Economic Affairs and Communications responded that the actions undertaken by AS Saarte Liinid for the reconstruction of the Triigi harbour were justified with the view of improving the servicing of the inhabitants of the islands. The Minister was of the opinion that the usufruct contract had to be extended until the investments are paid, to which the Leisi rural municipality agreed.

The Supervisory Board of AS Saarte Liinid responded that the points of the report were discussed in great detail and appropriate tasks were assigned to the Management Board. The Supervisory Board also noted its intent of making changes in the management system in order to make the accounting and financial management more effective.

According to the response from the Management Board of AS Saarte Liinid, the accounting will be concentrated in the central office as of July 1, 2004. The auditing firm ELSS was hired to compile new internal accounting rules; and other missing regulations will be presented for approval to the April meeting of the Supervisory Board. The unfinished building projects have been analysed and necessary amendments made. In the 1st half of 2004 the guidelines of public procurements will be developed. The Management Board also informed that the Chairman of the Board concluded contract of services with all the Management Board Members.

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