Economic activities of the Estonian Law Centre Foundation in the year 2003

Audit Report No. 2-5/04/79, 26 July 2004

Executive Summary

The purpose of the audit carried out under the work plan of the State Audit Office for the year 2004 is to provide an overview of the economic activities of the Estonian Law Centre Foundation between 1 January 2003 and 31 December 2003, while focusing on the relation of economic transactions to the primary objectives of the activities of the Foundation and highlighting the major findings concerning the lawfulness of transactions, the financial management of the Foundation and the functioning of its internal audit system.

Main findings

The following are the primary problems in organising the economic activities of the Foundation: the person exercising the rights of the founder has not been designated; supervision is inadequate; the internal audit system of the Foundation fails to secure sound financial management and to prevent infringements of the law.

- The foundation documents do not specify which of the founders – the Supreme Court, the University of Tartu or the Ministry of Justice – is the person exercising the rights of the founder. Pursuant to the Foundations Act, founders may exercise all the rights of the founder jointly unless the foundation resolution prescribes otherwise. In the opinion of the State Audit Office, the founders must agree in writing as to who will exercise the rights of the founder (amending the foundation resolution and the articles of association, as appropriate), in order to create an efficient control environment and prevent any later disputes. The position of the State Audit Office is that the Supreme Court should be designated as the person exercising the rights of the founder and thus be responsible for the supervision of the Foundation, because funds for the primary activities of the Foundation are allocated from the budget of the Supreme Court.
- While the articles of association prescribe that there should be nine members, the Supervisory Board of the Foundation has seven members.
- In the opinion of the State Audit Office, the supervision exercised by the Supreme Court over the activity of the Foundation has been insufficient. For the use of the 2,523,800 kroons envisaged in the budget of the Supreme Court for the Foundation an agreement was made which, among other things, prescribes the right of the Supreme Court to exercise supervision over the performance of the agreement. During the audited period the supervision exercised by the Supreme Court consisted in the review of the Foundation's reports. Although the Supreme Court had deemed the reporting of the Foundation as insufficient, the employees of the Supreme Court had not, in principle, examined the accounts of charges of the Foundation by the time of commencement of the audit. Moreover, the Supreme Court has not made any specific proposals for rendering the reports of the Foundation more transparent and verifiable. One of the major problems arising from the inadequate supervision is that it is unclear as to how the price of a training day offered by the Foundation is formed, on which bases the budget of the Foundation is drawn up or on which bases the training volume is agreed upon. Neither the employees of the Supreme Court nor of the Foundation were able to explain how the coordination fees and administration expenses included in the cost of a training day have been formed. According to the Director of the Foundation, these fees have been agreed upon with the Ministry of Justice before the appointment of the Director to the office. Hence, it may be concluded that while entering into the agreement for use of budgetary funds in 2003 the Supreme Court relied on earlier experience and it did not ascertain the essence and justification of the price formation principles applied by the Foundation.
- The project-based accounting of charges of the Foundation is inadequate, wherefore it is impossible to subsequently check the connection between a particular account of charges and the cost accounting of a project. Therefore, the State Audit Office sees the risk that not all costs incurred in connection with the provision of conference services are reflected on the invoices issued to customers. Moreover, inadequate cost accounting causes problems in drawing up subsequent budgets due to the lack of information that could be relied upon.
- Problems were detected in the assignment of grants: employees of the Foundation participate in public grant competitions announced by the Foundation. The Supervisory Board of the

Foundation has approved the procedure according to which the Director of the Foundation is entitled to decide on the assignment of grants of less than 75,000 kroons. In the opinion of the State Audit Office, the Director should not have sole discretion to decide on grants in the situation where employees of the Foundation are also participating in grant competitions, as that renders the impartiality of the decisions questionable. Furthermore, decisions approved by the Director of the Foundation with regard to the results of grant competitions do not specify the amounts for which agreements will be made with the grantees later. These amounts are agreed upon at the time of entry into the agreements. The position of the State Audit Office is that such a system is not sufficiently transparent for potential grantees. Moreover, it fails to ensure equal treatment of the grantees. In addition, such an arrangement may entail the risk that agreements are made for greater amounts than allocated for the Foundation for payment of grants.

- In the course of the audit, a violation of the Public Procurement Act and a conflict with the Income Tax Act were detected. The latter case concerned taxation of the grant paid to an employee of the Foundation.

Main proposals

To the founders of the Foundation

- To agree upon the exercise of the rights of the founder and to amend the foundation resolution and the articles of association, as appropriate.
- To bring the number of members of the Supervisory Board into conformity to the articles of association of the Foundation. In the case that the founders deem it reasonable to reduce the number of members of the Supervisory Board, that must be established in the articles of association.

To the Chief Justice of the Supreme Court

- To make the Supreme Court's supervision over the use of state budget appropriations more efficient, incl. to review and coordinate the principles of formation of the price of training of judges and to examine the reports of the Foundation as well as the documents underlying the reports on a regular basis.

To the Supervisory Board of the Foundation

- To broaden the circle of decision-makers in the cases where employees of the Foundation participate in grant competitions.

To the Director of the Foundation

- To maintain analytical project accounting concerning both training programmes and other services provided by the Foundation (e.g. conference services).
- To establish the winners of grant competitions and the amounts assigned to the winners by the directives of the Director before entry into grant agreements.
- To amend the internal audit system in a manner that would ensure the organisation of public procurement for purchase of goods and services. The need for organising public procurement can be evaluated, e.g. in the course of budgeting.
- To calculate and pay income tax to the Tax Board on the grants paid to the employees of the Foundation. In the future, to take guidance from the Income Tax Act upon disbursement of grants to the employees of the Foundation, and to assess income tax on such grants.

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