Economic activities of the Rural Development Foundation

Audit Report No 2-6/05/7 of February 8, 2005

Executive summary

The State Audit Office (SAO) has audited the economic activities of the Rural Development Foundation (RDF). The purpose of the RDF is to support the economic development of rural areas through the implementation of programs aimed at fostering enterprise. In order to achieve its goals, the RDF awards loans and offers collaterals.

As of 30 June 2004, the RDF including its predecessors has throughout its existence since 1997 given financial resources amounting to EEK 3.44 billion to the disposal of the entrepreneurs in its target group, of which loans make EEK 2.17 billion and the collaterals to banks for the credits granted make EEK 1.27 billion.

As of 30 June 2004, the balance of loans amounted to EEK 664.2 million and guarantee instruments with the risk assumed by the RDF amounted to EEK 190.8 million.

Main findings

The audit revealed that the RDF Statutes and a number of important regulations had not been brought into conformity with recent legislative amendments. The guidelines on lending operations and loan guarantees did not specify certain provisions with sufficient clarity.

On several occasions, the employees of the RDF did not respect the rules for crediting, terms of different loan products or the decisions of the Council, and they did not duly meet the commitments under co-operation agreements concluded with co-operation partners. Many loans had been awarded without relevant source documents: the list of land units to be acquired and their purchase prices, statements of local authorities on the economic activity of recipients, copies of insurance policies for collaterals, etc. Since data about the cost of investment were not made available, the requirement of self-financing could not be respected. In some cases the limits on self-financing were broken and the loans granted exceeded 75 % of the cost of investment. As regards loans to savings and loan associations, the RDF did not require source documents or compliance with terms and conditions of contracts. Some savings and loan associations had, during certain periods, received from the RDF more loans than the amount of their equity capital allowed.

The RDF did not have information whether all awarded loans were used for the intended purpose. During the loan using period the RDF had not required the beneficiaries to provide information stipulated in the contracts.

In case of loans made through the banks and financial institutions, the co-operation partners had not met commitments to the RDF and the latter had not required it, in most cases.

On some occasions the RDF had paid out amounts provided in the guarantee instruments according to the contracts made with the banks and not according to the terms and conditions laid down in the co-operation agreements, without even having sufficient information about the justification of the amounts subject to payment: there were no final reports on the repayment of loans or the exact damage sustained by the banks due to non-repayment of loans. Decision-making authority had not been established for the payment of guaranteed amounts. The RDF Council had not discussed in its meetings the justification of funds paid out under guarantee instruments.

The RDF had not analysed or assessed the effectiveness of the loans or the guaranteeing of financial transactions.

The RDF, with prior notification of the Ministry of Agriculture, had paid scholarships to students in agricultural specialities in secondary vocational schools. Further, the RDF had rendered financial aid to the non-profit association Chamber of Agriculture and Commerce for the management of coordinated dissemination of agricultural and rural economic information. The RDF had not required reports on the use of monies from the Estonian Chamber of Agriculture and Commerce.

The SAO deems necessary to draw the attention of the Minister of Agriculture to the following:

- The RDF has established the majority of required regulations and procedures, but in many cases these are not followed.

- A continuously functioning internal audit structure has not been developed and thus the Council members do not have necessary information about the actual observance of regulations.

- Shortcomings in the internal control structure do not instil confidence that the funds are used legitimately and to the purpose on all occasions.

Major proposals to the Minister of Agriculture

- Approve the new Statutes of the Rural Development Foundation that would be in accordance with the Rural Development and Agricultural Market Regulation Act, that would enable to identify in more detail the goals of the Foundation and to objectively evaluate the implementation of these goals.

- Give to the members of the RDF Council the following instructions and monitor their implementation:

    - In co-operation with the Ministry of Finance, to settle the issue of allocating resources to credit and financial institutions at no charge in accordance with the Competition Act.
    - Establish new RDF rules for crediting, taking account of the requirements of the Rural Development and Agricultural Market Regulation Act.
    - Review all terms of loan products and elaborate them in the light of the findings and observations cited in the audit report.
    - Analyse the effectiveness of the use of loans given by the RDF to the rural entrepreneurs. Require from the Board at least once a year a detailed report on the use of loans made to rural entrepreneurs along with the effects of loan uses and give an evaluation thereof.
    - Conclude new co-operation agreements with credit and financial institutions for the granting of both loans and collaterals, with a view to the amendments made to the legal acts in recent years.
    - Establish decision-making authority for paying out loan guarantees.

The audit report makes specific proposals to the Council and the Board of the RDF for the improvement of the control systems and the elimination of the shortcomings identified during the audit.

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The Minister of Agriculture stated in her reply that she would see to the implementation of the proposals made. The Statutes of the Foundation will be reconciled with the amended laws.

The President of the RDF Council stated that the Council had discussed the proposals and main conclusions made in the audit report at its meeting of 26 January 2005. The Board has submitted to the Council the new procedure for the application and processing of collaterals, the procedure for the application, processing and payment of subsidies and general principles on the co-operation agreements concluded with financial institutions. The RDF intends to improve co-operation with the savings and loan associations and regulate it in more detail. The shortcomings highlighted in the audit report are proposed to be discussed at the next meetings of the Council during 2005. The Council has decided to set up an audit committee for the improvement of internal control.

The Chairman of the RDF Board, in his reply, considered the conducted audit to be highly beneficial for the further operation and development of the RDF. The Chairman also commented on the facts and conclusions cited in the audit report, due to which a few additions and corrections have been made to the final version of the audit report.

Jüri Kõrge
Chief Auditor
Audit Department III