

Organization of accounting and legality of transactions within the area of administration of the Ministry of Social Affairs in 2004

Audit report No. OSIII-2-6/05/108 of August 15, 2005

Summary

The State Audit Office (SAO) has audited the organization of accounting and the legality of transactions in the area of administration of the Ministry of Social Affairs in 2004. The goal of the audit was to obtain reasonable assurance, by testing the work of internal and external auditors, that on the basis of the work performed by the auditors for forming an audit opinion on the annual report and the additional audit procedures conducted, the SAO may evaluate the organization of financial accounting and the legality of transactions of the accounting entities operating within the area of administration of the Ministry of Social Affairs. In addition to the audit procedures conducted by internal and external auditors, the SAO auditors also performed additional audit procedures.

As the outcome of the audit, we have presented our major findings for the organization of financial accounting (incl. operation of internal controls), the legality of transactions and financial management within the area of administration under discussion.

Since the Social Insurance Board is a component unit of the Ministry of Social Affairs and the North Estonia Regional Hospital is a foundation operating within the area of administration of the Ministry of Social Affairs, this report includes main observations from the SAO audits on "Organization of payment of parental benefits" and "Organization of procurement in the North Estonia Regional Hospital Foundation".

Pursuant to the amendment to the State Budget Act, the person responsible for internal audit in the Ministry of Social Affairs is obligated to render an opinion on the Ministry's 2004 annual report and the legality of transactions. The SAO must express an opinion on the 2004 consolidated annual report and the legality of transactions of the government. The SAO may, during the course of auditing the Government's annual report, rely on the audit opinion of the person responsible for internal audit in a government financial reporting entity in respect of the fairness of the annual report and the legality of transactions of the reporting entity.

Main observations

Organization of accounting and the internal control system

- Accounting practices within the area of administration of the Ministry of Social Affairs are sloppy and do not ensure the availability of timely, relevant, unbiased and comparable information about the financial position, results of operations and cash flows of the accounting entity. The SAO noted deficiencies in financial accounting in the agencies operating within the area of administration of the Ministry in respect of recording fixed assets and inventories and liabilities, the physical count of assets, consolidation of annual accounts and disclosure of off-balance sheet arrangements.
- The Ministry of Social Affairs has failed to establish internal accounting rules and procedures for the area of administration consistent with the general accounting policies of the state. Further, not all agencies subordinate to the Ministry have established internal accounting procedures in line with the specific nature of the agency's business. The Ministry has not established cash handling procedures consistent with the general accounting policies for those financial reporting entities within the area of administration who handle and have cash on hand. The need to improve the internal control system is proved by the fact that the Ministry has not made prior arrangements in writing for the renovation work to be performed on the property in its possession.
- The 2004 annual report of the Ministry of Social Affairs was signed belatedly on 28 June 2005 (the deadline was 31 May 2005).
- The SAO performed audit procedures for examining the management report and found that the management report did not provide information about the Estonian Health Insurance Fund and the Estonian Unemployment Insurance Fund, the legal persons governed by public law operating within the area of administration of the Ministry of Social Affairs, there were errors in numerical

data, and the figures presented in the management report did not always match the figures in the annual report.

Legality of economic transactions and financial management

As for the legality of transactions, the SAO detected serious shortcomings in compliance with the Public Procurement Act and numerous infringements of the State Budget Act. As for financial management, findings were made in respect of allocation of budgetary expenditures before the viability of expenditure proposals had been finally determined. Further, the SAO auditors identified a conflict of interests for officials who decide on the allocation of budgetary resources.

The audit of the organization of the payment of parental benefits conducted by the SAO in the Social Insurance Board highlighted several problems relating to the recovery of benefits overpaid due to the recipients' failure to notify the Pension Board of any and all circumstances concerning the payment of the benefit and the size thereof. The SAO found that the system of paying parental benefits does not rule out a possibility that the benefit is also paid to parents of children placed in a child care institution.

Reliance on the work of internal auditors

As a result of the audit procedures conducted, the SAO has come to the conclusion that, upon issuing an opinion on the consolidated annual report of the government, we can rely on the work of internal auditors and the opinion of the person responsible for internal audit on the annual report of the Ministry of Social Affairs, except for the management report that was not audited by internal auditors and for which the SAO itself performed audit procedures. The opinion of the Internal Audit of the Ministry of Social Affairs regarding the annual report states that, due to the scope of the audit, the internal auditor cannot and will not render an opinion on the 2004 consolidated financial statements of the Ministry of Social Affairs as a government reporting entity or the legality of its transactions.

The internal auditor has issued an opinion on only the fair presentation of the annual financial statements, not the entire annual report as required by the State Budget Act.

The internal auditors pointed out that the findings and proposals made by the SAO (concerning the Ministry of Social Affairs and the Labour Market Board) as a result of the audit of the previous fiscal year have been left, in the main part, without proper attention, since similar problems and deficiencies were detected during the audit of the 2004 annual financial report.

Proposals to the Minister of Social Affairs

- Establish internal accounting rules for the agencies within the area of administration of the Ministry of Social Affairs in accordance with the general accounting policies of the state, and establish cash handling procedures for each agency within the area of administration engaged in cash transactions.
- Record leases on the basis of their economic substance.
- Avoid in the future the assumption of long-term irrevocable obligations prohibited by the State Budget Act.
- In performing a physical count of fixed assets and inventories, require observance of the procedures and deadlines set in the general accounting policies of the state for the inventory and valuation of assets and liabilities.
- Improve the internal control system in such a way as to ensure:
 - organisation of public procurement in compliance with the Public Procurement Act;
 - disbursements from the state budget in accordance with the classification and nature of costs as provided by the State Budget Act;
 - as effective implementation of the state budget as possible. Arrange for financial management and budgeting in agencies in such a way that the agencies, in expenditure planning and budgeting, would estimate the need to enter into procurement contracts in order to ensure the timely conclusion of all procurement contracts at the most favourable terms for the state;
 - organisation of financial accounting in such a way that would enable to present the annual report in due course;
 - reporting on the balance sheet of all inventories held by the agencies within the area of administration;
 - prior arrangements with the user of property for renovation works on the property in the Ministry's possession;
 - presentation of all off-balance sheet accounts in the record of balances of agencies;

- performance of all closing entries for the consolidation of the annual report of the Ministry of Social Affairs and presentation of correct information in the financial statements.
- Develop and establish procedural rules governing the activity of the committees (rules of procedure) set up in the Ministry in order to harmonize their work and ensure its objectivity and effectiveness; among other things describe in detail the procedure for the appraisal of applications and the granting of assistance. Establish rules for allocation of assistance in the case when the applicants are involved with the members of the committee.
- Find out the reasons for failure to eliminate the shortcomings in the Ministry and the agencies within its area of administration that the SAO highlighted in the preceding year already. The SAO recommends that persons responsible for corrective action be identified and the issue of their liability be resolved.

The **Minister of Social Affairs** stated in his reply that the observations made would be taken into account in the organization of work in future. The development of internal accounting rules has been started, procedural rules for taking inventory both in the Ministry and its subordinate agencies are being prepared, review of procedures pertaining to budget allocations have been started and the need for modifying the current policy on organizing public tenders is under discussion. The Minister stressed the need to amend legal acts so as to establish specific rules for the conclusion of lease contracts and their recognition in the accounts. The Minister did not agree with the remarks made about the consolidation of the annual report.

The SAO shares the opinion of the Minister of Social Affairs that legal acts should in more detail govern the issues concerning the lease contracts. As for the consolidation of the annual report, the SAO adheres to the viewpoint expressed in the preliminary audit report.

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