

Organisation of accounting and legality of transactions in the area of government of the Ministry of Defence in 2004

Audit report No. OS-II-2-6/05/105 of August 12 2005

Summary

The SAO audited the organisation of accounting and legality of transactions in the area of government of the Ministry of Defence in 2004. The objective of the audit was to evaluate the work of internal auditors in auditing the annual report, and the organisation of accounting in the Ministry of Defence and the agencies in its area of government, as well as the legality of economic transactions carried out in 2004. In addition to evaluating the work of internal auditors and the general organisation of accounting, inventory of state assets, granted and received benefits, economic expenses (incl. mission expenses) and personnel expenses were audited in the Ministry of Defence. The report also covers the main observations about the organisation of accounting and legality of transactions audits performed in the area of government in Single Signal Battalion, Naval Headquarters and E-Arsenal Ltd, which is owned by the state.

As a result of the audit, main observations about the work of internal auditors, organisation of accounting, legality of transactions, internal audit system and financial management, as well as the main observations of the internal auditors have been pointed out. All in all, mostly the observations and suggestions related to the area of government have been pointed out.

Arising from State Budget Act, the person responsible for the internal audit of the Ministry of Defence has to evaluate the annual report and legality of transactions of the area of government of the Ministry of Defence in 2004. The SAO has to evaluate the consolidated annual report of the state and legality of transactions in 2004. In the course of the audit of the annual report of the state, the SAO can rely on the evaluation of the person responsible for the internal audit of the Ministry of Defence on the authenticity of state accounting entity's annual report and legality of transactions.

Opinion on the work of the internal auditors

As the internal auditors have not audited a sufficient volume of the annual report of the area of government of the Ministry of Defence, the person responsible for the internal audit has not evaluated the report of the area of government. The SAO can rely on the work of the internal auditors of the General Staff of Armed Forces in the part they have audited, because the work of the internal auditors was in compliance with the guidelines of Financial Audit Manual of the Ministry of Finance. The SAO finds it necessary to note that the risk assessment of the internal auditors differed from that of the SAO, and that no risk assessment was carried out in the area of government of the Ministry of Defence.

Opinion on the activities of the Ministry of Defence in evaluating the report of the area of government

The SAO is of the opinion that the Minister of Defence did not pay timely attention to the fact that there would be enough employees in internal audit departments and that the person responsible could fulfil his duty and evaluate the annual report of the area of government.

Organisation of accounting

Relying on the audits of the SAO, internal auditors and external auditor, the SAO points out the following:

- The level of accounting in the Ministry of Defence is uneven. In the evaluation of the SAO the Ministry of Defence has not sufficiently co-ordinated the accounting in its area of government. Accounting policies and procedures need to be supplemented and harmonised within the entire area of government based on the speciality of the authorities' activity and the requirements of the general rules of state accountancy.
- The person responsible for the internal audit of the General Staff of Armed Forces did not evaluate the authenticity of stock records or legality of transactions related to stock. 91 % (total of EEK 961.8 million) of the stock in the area of government of the Ministry of Defence was

located in the Estonian Defence Forces Logistic Centre. Of the stock in the consolidated balance sheet of the state, the said stock forms approximately 80 %.

- As appropriations to the National Defence League, the Ministry of Defence has showed in its report expenditure on buying in guarding services from the National Defence League, which in the evaluation of the SAO should have been recorded as economic expenditure in the reports of every agency that bought the service in the area of the government. The Ministry of Defence is of the opinion that it should not be regarded as buying in guarding services but as training of defence leaguers.
- Problems were identified in recording assets obtained in a centralised procedure in the agencies of the area of the government.
- No proprietary liability contracts were concluded in military units with persons, who are responsible for the registration and preservation of tangible assets

Functioning of the internal audit system

- In the evaluation of the SAO, Naval Headquarters' monitoring of the ships' fuel consumption was not in satisfactory level.

Legality of economic transactions and financial management

- State's participation as an owner in E-Arsenal Ltd in the area of government of the Ministry of Defence has in conclusion brought damage to the state and is thus not in compliance with State Assets Act.
- The process of budget amendments is lingers often and thus unreasonable advance payments have been made at the end of the year. The SAO finds is of the opinion that such financial management, where several necessary expenditure is carried out only at the end of the year can act as an impediment to the activity and development of the military unit.
- The Ministry of Defence lacks common rules that would regulate the gifts made to employees, conscripts and visitors, and that are regarded as fringe benefits.

Follow-up audit of the audit observations of the previous year

As a result of the follow-up audit, the auditors found that the suggestions made by the SAO in the previous year have generally been met.

Main suggestions to the Minister of Defence

- Review the accounting policies and procedures for the agencies in the area of government of the Ministry of Defence and give specific instructions for their supplementations, based on the speciality of activities of the general rules of state accountancy and individual agencies.
- Supplement the information technology section of Estonian Defence Forces Logistic Centre's stock records to give a current and credible overview of the assets.
- Improve the internal audit systems in the area of government of the Ministry of Defence so that the following would be ensured
 - the timely registration and write-off of fixed assets obtained and issued in a centralised procedure;
 - preservation of fuel and other liquid (easily realised) stocks.
- Develop rules that would regulate exactly with who and on what conditions proprietary liability contracts will be concluded, which would take into account the interests of both parties.
- Continue reinforced surveillance of the activity of E-Arsenal Ltd. to prevent the situation where the economic activities of the public limited company are still damaging the state.
- Analyse the reasons and develop precautions for accelerating the process of reasoned amending of the budgets of sub-offices to avoid needless advance payments and accelerate the completion of necessary buildings and other objects
- Develop a common procedure for the area of government, which would regulate the expenditure on gifts and other expenses regarded as fringe benefits, establishing in which cases and in what scope it is allowed to make gifts, taking into account the prerequisite that making gifts is more of an exception than a rule
- Ensure that there would be enough employees in internal audit departments of the agencies in the area of government of the Ministry of Defence to evaluate the annual report of the next economic period

- Draw up a risk assessment for the next accounting period, which would cover the entire area of government and would be the basis for the performed audits.

In a reply to the draft audit report the Minister of Defence concurred with the observations and suggestions of the SAO and presented an overview of the planned actions. In the organisation of the activity of E-Arsenal Ltd the Ministry of Defence has taken radical measures, appointing new members to the supervisory board and management board. Working group with regular meetings has been appointed to carry out surveillance.

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