Economic activities of the Foundation for Building the Art Museum

Audit Report No. OSIII-2-6/06/23 of April 18, 2006

Summary

To start the design and construction works of the new building of the Art Museum of Estonia, the Government of the Republic established the Foundation for Building the Art Museum in 2001, appointing the Ministry of Culture to exercise the rights of the founder in the name of the state. The new building of the Art Museum was completed and it was accepted on 31 October 2005.

The objective specified in the articles of association of the Foundation is to organise and finance the construction of the building complex of the Art Museum of Estonia, to repair and reconstruct the buildings that are in the possession and at the disposal of the Foundation, and to administrate these buildings and the completed building complex. The Foundation uses its revenues and assets only to reach the objectives specified in the articles of association of the Foundation.

The aim of the audit was to assess the economic activities of the Foundation for Building the Art Museum between 2001–2005, while focusing on the relation of economic transactions to the main objectives of the activities of the Foundation and highlighting the major findings concerning the lawfulness of transactions (incl. the adherence to the Public Procurement Act), the financial management, the organisation of accounting, and the functioning of the internal audit system. The purpose of the audit was also to establish the cost of building the museum and the reasons for its growth compared to the estimated cost.

As a result of the audit, the SAO concluded the following:

The growth in the construction cost of the Art Museum of Estonia when compared to the initially estimated cost was EEK 264 million; EEK 77.7 million starting from the awarding of the contract for services. At the beginning of the construction work, the Supervisory Board of the Foundation decided that the construction cost together with loan interests should not exceed EEK 600 million. After awarding the contract for services in August 2003, the Foundation estimated the approximate construction cost of the new building of the Museum to be EEK 786.3 million. The actual cost, however, turned out to be EEK 864 million.

The cost of the new building of the Art Museum increased due to the construction of the tunnel, a slight shift in the initially planned location, modifications to the project, additional architectural solutions, additional works, several changes regarding building materials and furniture, and a great number of commissioned expert opinions. The Foundations has commissioned expert opinions on the circumstances of the rise in the cost of the building and the Supervisory Board of the Foundation has accepted the growth. Therefore, the SAO has no reason to doubt that the growth in the cost was unjustified.

The changes in the volume of some works that caused the growth in construction costs were not sufficiently documented (the mining and utilisation of bituminous argillite in the course of preparatory works). In the SAO’s opinion, the Management Board of the Foundation was not active enough in finding opportunities to reduce expenses (the disposal of purchased bridge bones, exclusion of furniture from the procurement for constructor, deduction of the constructor’s overhead costs and profit when decreasing the volume of the contract for services).

In most cases, public procurements were organised in the prescribed manner. The Foundation had bought the service of public procurement organisation from several companies and undertakings.

The notice of invitation to tender for construction was released too early, as the full design documentation had not been completed by that time. In addition, there were mistakes in the initial tender documentation of public procurement that could have been avoided. All this together enabled to challenge the procurement.

At the same time, it became evident that in some cases, public procurements were not organised (e.g. for finding the organiser of asset sales, contracting for additional preparatory works of the construction, etc).

The Foundation covered the expenditures of the Art Museum of Estonia to a great extent. Although pursuant to its articles of association, the Foundation can use its revenues and assets only to reach the objectives specified in the articles of association, it had incurred the expenses that should have been incurred by the Art Museum several times. The audit identified such expenses in the amount of EEK 2.83 million. For example, pursuant to its Supervisory Board decisions, the Foundation paid EEK 1.2 million for the maintenance works of the buildings belonging to the Art Museum of Estonia, bought assets to the Museum in the value of EEK 1.3 million, paid EEK 187,600 for the development of the Museum's organisational structure, mission and vision and the training of the Museum managers, etc.

By allowing the covering of the Art Museum's expenses, the Supervisory Board of the Foundation went beyond its authority and violated the articles of association of the Foundation.

Several deficiencies were detected in awarding the contracts of employment and service, and calculating and paying remuneration for the members of the Supervisory Board on the basis of these contracts. For example, remuneration of members of the Supervisory Board was paid every month also to those members of the Supervisory Board, who did not take part of the decision-making, despite the fact that pursuant to the Regulation of the Minister of Finance, they should not receive remuneration.

There were deficiencies in the Foundation's internal audit system and organisation of accounting. For instance, neither the manual of managing and auditing of financial activities nor the accounting policies and procedures include the principles of budgeting nor establish the rules that would prescribe which expenses must be calculated on which budget lines. Due to the lack of single and distinct principles, it is not clear which expenses are being planned and this makes it impossible to verify in the execution of the budget whether the expenditures were made according to the plans or not. Therefore, the report on the execution of the budget also fails to perform its task. In some cases, the assets were not registered in the right time, in the total amount and in the right value.

The Foundation has lent the main part of the building to the Art Museum of Estonia for free use. Pursuant to the economic substance of the concluded contract of loan for use, the Foundation must exclude some of the buildings and assets given for the use of the Museum from its balance sheet and keep off-balance-sheet accounts. The Art Museum must keep the balance sheet accounts of these assets.

The SAO has developed proposals to the Supervisory Board and Management Board of the Foundation for improving the internal audit system and accounting. Proposals are provided next to individual thematic block of the audit report.

The SAO also notes that in the future, before establishing legal entities for the construction of new buildings or renovation of the existing ones, the Minister of Culture should seriously consider the need for such entities and the related risks, while taking account of the observations and conclusions made in this audit report.

***

In his reply, the **Minister of Culture** thanked the SAO in the name of the Supervisory Board of the Foundation for a thorough draft audit report. The Minister also notified that the Management Board has submitted detailed explanations on the assessments made in the draft, and the planned measures will be introduced in the meeting of the Supervisory Board of the Foundation for Building the Art Museum on 26 April 2006, and the observations made in the draft will be regarded in the future management of the Foundation. In addition, the Minister promised to consider the proposals made in the draft audit report regarding the awarding of contracts for construction services and the confirmation of the composition of the Supervisory Board.

The **Minister of Finance** indicated that he does not consider it rational to change his Regulation on "The Procedure for Remuneration and Limits for the Remuneration of the Members of Supervisory Board of the Foundations and Undertakings Controlled by the State," as the work and duties of the members of the supervisory board of a foundation are not limited to taking part of the meetings of the supervisory board, but they must also perform the general obligation of conscientiousness between the meetings. Additionally, the Minister found that the responsibilities of a member of supervisory board will remain also for the period that decisions are not made.

A member of the Foundation Management Board notified that the new Management Board has thoroughly studied the draft audit report and in the future activities of the Foundation, the assessments and proposals of the draft will be taken into consideration, and the Foundation has begun to improve the internal audit system. In its reply to the draft audit report, the Management Board of the Foundation presented its views on reflecting the new building of the Foundation and the Art Museum in the accountancy, and on subjecting to VAT.

Having regard to the reply of the member of the Management Board, the **SAO** specified the part of the text in the draft audit report (p 3.4) that concerns the reflection of foundation capital.

Jüri Kõrge
Chief Auditor
Audit Department III