HASCO project of the European Commission in the rural municipality of Sonda

Audit report No. OSI-2-6/06/39 of 15 June 2006

Summary

The National Audit Office audited the circumstances of reclaiming the support funds of the European Union on the basis of the inquiry of the Mayor of the rural municipality of Sonda of 21 July 2005. The audit focused on examining and analysing the activities and documents of a project titled 'Oil-Shale Semi-Coke Processing into Soil Improver, Soil Improver Used to Stabilise Slurry and Restore Damaged Soils for Foresting Mainly with Hybrid Aspen' financed by the European Commission (hereinafter the HASCO project). The European Commission approved the project, which was financed out of the Financial Instrument for the Environment (LIFE), on 2 August 2002.

The purpose of the HASCO project was to mix oil shale ash (semi-coke) and agricultural slurry by using a new technology and thus reduce the impact on the environment, re-cultivate the open pits of the abandoned mine in Ida-Viru County by planting hybrid trees and thereafter use the expertise obtained from the trial project more extensively. The project comprised 10 states, which contained sub-goals and descriptions of activities conducted for obtaining them. According to the project plan the total cost of the project was 55.5 million Estonian kroons of which 19.9 million was to be contributed by the European Commission and 35.7 million was to be allocated by the beneficiary and partners as self-financing.

The European Commission make a payment of 505,994 euros (7.9 million Estonian kroons) for commencing implementation of the project – the European Commission made no more payments. In addition to the amount the rural municipality of Sonda took a loan of 3.8 million Estonian kroons from the Environmental Investment Centre in order to cover the rural municipality's self-financing for a short term (as bridge financing).

The European Commission terminated the HASCO project on 23 February 2005 because the reports of the rural municipality or the visit of the Commission on 25 November 2004 did not allow for assessing which results have been achieved upon implementation of the project. In the same letter the Commission notified of the claim for repayment of the money. Earlier, the Commission had repeatedly warned that if the rural municipality did not submit correct reports on using the money, the money would be reclaimed. In addition to the repayment obligation before the European Commission the rural municipality must repay the loan obtained from the Environmental Investment Centre, because the rural municipality did not use it according to the intended purpose. As of 23 May 2006 the rural municipality has not commenced repayment of the 11.7 million Estonian kroons. The Eastern Police Prefecture has initiated an investigation into the use of the project funds.

The National Audit Office is not certain that the rural municipality submitted to the Office all the materials that the project partners gave to the rural municipality, because in several instances the partners claimed that they have already submitted the materials requested by the National Audit Office to the rural municipality in the course of the project. The National Audit Office is also not certain that all the partners have submitted to the Office the entirety of the documentation pertaining to the project.

Having analysed the materials of the HASCO project which were submitted to the National Audit Office and the explanations given it has to be admitted that due to the insufficient documentation it was difficult and in several instances virtually impossible to assess the exact chronology of the events and the content of transactions. Following the audit the National Audit Office drew the following conclusions:

- The supervision exercised by the Council of the rural municipality of Sonda was not sufficient, because the Council did not demand that the Government of the rural municipality submit the project to the Council or pay sufficient attention to the implementation of the project or the problems indicated in the memorandum of the auditor of the rural municipality. The failure to act by the Council could have been affected by the mutual contracts for services made by the Chairman of the Council and the Mayor of the rural municipality for the implementation of the project.
- The management of the project was insufficient: the project management work groups did not meet in reality; all the partners involved in the project were not suitable for implementing the

project tasks financially or in terms of their expertise; upon incurring costs the project budget was not adhered to; there was no supervision of the performance of the duties.

- Only three out of the requested nine reports were submitted to the European Commission. The last one of 17 December 2004, where the rural municipality claimed that most of the goals of the project have been achieved, was poorly made. The project results given in the report had not been certified by source documents; the report accounted for costs which had not been incurred or which were not backed by any evidence.
- The demands of the European Commission were reasoned, because the rural municipality of Sonda had violated the rules for receiving aid: it did not submit the required reports; it did not prevent a conflict of interests; it did not enter into due contracts with the partners; it did not preserve the documentation certifying the implementation of the project.

The failure of the HASCO project has lead to a situation where the obligations assumed under the support project almost equal the annual budget of the rural municipality as a result of which it is unlikely that the rural municipality will be able to repay the money itself. Currently it is not clear who will perform the obligations in such a situation. The Government of the Republic has so far not suggested a solution on how to prevent local authorities from running into solvency problems, what to do with local authorities that have come to a difficult financial situation and how the supervision over the financial status of local authorities should function.

Suggestions

To the rural municipality of Sonda

- To draw up an action plan for performance of the obligations and submit it to the Council of the rural municipality for approval.

To the Minister of Finance

- To speed up the submission to the Riigikogu of the draft acts regulating the financial management and resolution of the insolvency of local authorities drafted by the Ministry of Finance.

To the Supervisory Board of the Environmental Investment Centre

- To analyse the necessity of the supervision exercised by the Environmental Investment Centre over the use of the loans given to local authorities.

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In their replies to the draft audit report of the National Audit Office the Mayor of the rural municipality of Sonda as well as the Supervisory Board of the Environmental Investment Centre agreed with the suggestions of the National Audit Office. In his reply the Minister of Finance promised to submit both draft acts to the Government of the Republic by October 1 this year.

The replies of the parties involved, including those of the project partners have been annexed to the audit report.

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