Structure of internal audit system, organisation of accounting (incl. disclosure of financial information) and legality of transactions in Saare Rural Municpality in 2004 and 2005

Audit report OSV-2-6/06/69 of 31 July 2006

Summary

The purpose of the audit was to assess the conformity of the organisation of accounting in Saare Commune with the legislation and instructions regulating the accounting, the conformity of the commune's economic activities with the regulating legislation and functioning of the internal audit system implemented for the purposeful and lawful use of the commune's funds. The audit does not give an assessment to the annual accounts of 2004 and 2005 but lists important observations regarding the organisation of accounting and functioning of the internal audit system as well as the legality of transactions in the audited areas.

The NAO identified shortcomings in the internal audit system of Saare Commune, which is why the lawfulness and purposefulness of economic transactions, management of important risks and avoiding mistakes has not been ensured. There are shortcomings in the organisation of accounting of Saare Commune which have led to significant errors in financial reports. Both state and commune legislation has been violated when concluding economic transactions.

Of the audited transaction classes, the NAO did not identify significant errors regarding the accounting of aids allocated for operational expenditure and the legality of transactions regarding short-term claims and advance payments.

Main observations

- There are certain bottlenecks in the internal audit system of Saare Commune, which is why the system does not act effectively in managing important risks and avoiding errors. For instance, the Audit Committee's monitoring over the activities of the Commune Government is modest, also, the so-called principle of the separation of tasks has not been followed in making transfers from bank accounts. It was also identified that the Audit Committee's monitoring activities include only annual inventories of assets and that it gives an assessment to the annual report and report on the execution of the budget, paying no attention to the legality of the commune's economic activities.
- There are significant shortcomings in the accounting of fixed assets of Saare Commune, which are shown in the incomplete recording of the pool of the commune's fixed assets and in the recording that does not comply with the transactions' economic substance. Saare Commune has not relied on the on the transaction's economic substance in recording the short-term loan of 1,025,000 kroons taken to complete the construction of Voore Activation Centre, and in renting three Peugeot vehicles in the sum of 520,936 kroons. The commune has not included all acquisition expenses of fixed assets made in the construction of Voore Boarding School and Koseveski hydropower station in a total of 210,285 kroons in the fixed assets' acquisition cost, nor has it recorded the Mann registered immovable as fixed assets.
- Transactions have been carried out in Saare Commune which are prohibited pursuant to Anti-corruption Act. Saare Commune Mayor has concluded transactions in the name of the commune with legal persons, at the same time belonging to their management or control bodies.
- Saare Commune has expenses that are not covered by the budget. In 2005, a sum of 350,000 kroons was generated for the non-profit association Activation Centre of the Local Governments in Jõgeva County, which was not approved by the budget.

Main proposals

To Saare Commune Government

- Improve the internal audit system by organising thorough inventories to ensure the preservation of the commune's pool of assets, enchancing control over the use of money in bank accounts and disclosing all information pursuant to the Public Information Act in the rural municpality's website.

- Carry out a thorough inventory of tangible assets in order to assess the substance and completeness of the assets being recorded in the balance sheet as well as the conformity of the useful lifetime of the assets with its actual lifetime.

To the Council of Saare Commune

- Enhance the internal audit system through a better organisation of the work of the Council's Audit Committee.
- Review the „Procedure for the possession, use and disposal of the assets of Saare Commune" in order to assess the relevance and adequacy of the limits of the competence to adopt decisions established by this procedure as well as of the rules of procedure of economic transactions concluded with the commune's assets, and make changes to the said procedure, if necessary.

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Saare Commune Government and the Council of Saare Commune concurred with all assessments stated in the NAO's report and gave additional explanations.

The Council of Saare Commune plans to carry out a thorough inventory of the accounting of tangible fixed assets in 2007; monitors that the rural municpality budget would be approved pursuant to the procedure laid down by the Commune and City Budgets Act; reviews the procedure for the possession, use and disposal of the assets of Saare Commune in 2006, making necessary amendments; and establishes procedures for the allocation and payment of aids. For the best interests of the commune, the Council of Saare Commune considers it necessary for the Commune Mayor to continue participating in the directing bodies of established non-profit associations and foundations and appoints another person to conclude transactions with them. The Council of Saare Commune requires for the Audit Committee to develop a work schedule and allocates additional resources for auditing the legality of the commune's activities.

Saare Commune Government will specify in 2006 the rules of procedure for transactions with fixed assets as well as the responsibility for said transactions and carries out its accounting and recording of financial transactions pursuant to the legislation, incl. the accounting policies and procedures of the Council of Saare Commune, and brings the information in the commune's website into conformity with the Public Information Act.

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