Organisation of the internal control system and accounting and the legality of the economic transactions in the City of Paldiski in 2004 and 2005

Audit report No. OSV-2-6/06/96 of 29 November 2006

Summary

The purpose of the audit was to assess the operation of the internal control system applied for the purpose of ensuring purposeful and lawful use of the funds of the City of Paldiski, the compliance of the organisation of accounting in the City of Paldiski with accounting legislation and instructions, and the compliance of the economic transactions with applicable legislation. During the audit annual accounts 2004 and 2005 of the City were not assessed. Instead, the audit points out the main observations regarding the operativeness of the internal control system, the organisation of accounting, and the legality of the transactions.

The City Government of Paldiski was not very helpful in the matters concerning accounting, i.e. did not submit the documents requested by the auditors in a timely manner or at all. The National Audit Office finds that the lack of cooperation may be partially attributed to the insufficient skills of the Estonian language of the accountants of the City Government of Paldiski. Due to the insufficient Estonian skills most of the accountants had to be interviewed in Russian.

The National Audit Office addressed the Language Inspectorate with a proposal to exercise supervision over adherence to the Language Act in the City Government of Paldiski. According to the National Audit Office there is no functional internal control system in the City of Paldiski, which would ensure purposeful use of the City's budget funds and prevent mistakes in the annual accounts, entry into harmful transactions, etc. There are serious deficiencies in the organisation of the accounts in the City of Paldiski, as a result of which the assets and liabilities of the City have not been fully covered in the annual accounts. Economic transactions conflicting with legislation have been performed in the City of Paldiski.

As for the audited transaction classes the National Audit Office did not detect any serious mistakes in transaction classes "interest payable on tax arrears" or "support received for a specific purpose."

Main observations

- There are serious deficiencies in the internal control system of the City of Paldiski. For example:
    - The provisions of the state and City legislation have not been adhered to upon budgeting or implementation of the budget, records management, asset and liability accounting, disclosure of documents and data (incl. local legislation), organisation of inventory checks, etc.
    - The accounting policies and procedures of the City Government of Paldiski do not regulate the areas of accounting in sufficient detail, as a result of which the operativeness of the internal control system in the accounts of the City is not ensured.
    - The internal work organisation rules (accounting policies and procedures, procedure for records management, rates and terms of remuneration approved by the Council) of the City are not complied with.
    - In the Paldiski Rehabilitation Centre Foundation the cash transaction provisions of the accounting policies and procedures have not been followed, as a result of which the organisation of the cash transactions of the Foundation is bad in the opinion of the National Audit Office.
    - The supervision exercised by the Audit Committee over the City Government and the agencies administered by the latter is insufficient, because the Committee has not organised systematic inspections in the audited period.
- There are deficiencies in the organisation of the accounting of the City of Paldiski, which have brought about serious mistakes in the reports (incl. various elementary mistakes in the accounting of the fixed assets), which the City Government had not taken into account due to the weakness of the internal control system. For example:
    - Not all the fixed assets of the City had been registered.

    - The fixed assets of the upper secondary schools in Paldiski had been registered inclusive of value added tax.
    - The appropriations pertaining to the closure of the landfill of the City and a court judgment, which had entered into force, have not been accounted.
- Upon organisation of auctions for the transfer of the assets of the City of Paldiski the provisions of the statutes of the City of Paldiski have not been followed upon publication of the auction notices and setting the opening price.
- The City Government of Paldiski has, without any decision on the part of the Council, paid support the payment of which is not regulated by any procedure adopted by the Council.

Main recommendations

To the Council of the City of Paldiski

- To improve the work of the Audit Committee of the Council in order to ensure systematic supervision over the City Government and the agencies administered by the latter. If necessary, to involve experts in the work of the Audit Committee.
- To establish procedures for payment of support by the City of Paldiski.
- To ensure adherence to the procedure for publication of the legislation adopted by the Council and Government of the City of Paldiski or bring the statutes of the City into compliance with the practice of publication of legislation.
- To take a position regarding the pay and support paid to the officials of the City Government without any legal basis.

To the City Government of Paldiski

- To promote the internal control system, incl. to introduce an electronic records management system, to adhere to legislation upon budgeting and implementation of the budget, to improve the publication of information, to organise inventory checks of the assets and liabilities as required.
- In the organisation of accounting, to adhere to the provisions of the legislation of the state and City and internal procedure rules of the City and, to that end, train the accountants in the City Government and the agencies administered by the latter.
- To adhere to the procedure for publication of notices and setting the opening price in auction proceedings organised for the purpose of transfer of the assets of the City of Paldiski as stipulated in the statutes of the City.

To the Supervisory Board of the Paldiski Rehabilitation Centre Foundation

- To audit the purposefulness of the cash transactions of the Foundation and to ensure adherence to the state legislation and accounting policies and procedures regulating cash transactions.

To the Management Board of the Paldiski Rehabilitation Centre Foundation

- To carry out inventory checks of the assets of the Foundation to the extent and with the frequency provided for in legislation.

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The replies of the Council and Government of the City of Paldiski and the Supervisory Board and Management Board of the Paldiski Rehabilitation Centre Foundation have been annexed to the audit report of the National Audit Office.

The Council of the City of Paldiski and the Paldiski Rehabilitation Centre Foundation confirmed in their replies that they take the elimination of the deficiencies indicated by the National Audit Office and the recommendations of the National Audit Office very seriously. The Council of the City of Paldiski does not agree with the opinion of the National Audit Office that the City Government did not cooperate in matters concerning accounting. The Council also finds that the National Audit Office treated the subject of the sale of the apartments belong [belonging?] to the City arbitrarily, without taking the explanations given by the City into account.

The National Audit Office would like to note that the National Audit Office asked the Mayor, the Deputy Mayors and the Chairman of the Council of Paldiski for explanations regarding the transfer of the assets of the City, but no explanations of documents refuting the violations pointed out by the National Audit Office were submitted. No such explanations have been given in the reply of the Council to the draft audit report of the National Audit Office.

The City Government of Paldiski promised to take the notes made by the National Audit Office into account in the future. Various notes have already been taken into account in the work of the Council and Government of the City of Paldiski. For instance, the rates and terms of remuneration in the City Government (incl. the procedure for payment of various supports) are being adjusted. Also, the statutes of the City and the procedure for management of the assets of the City will be amended soon. The deficiencies in records management will be eliminated by the beginning of 2007 and the deficiencies in the organisation of accounting are being eliminated. The City Government of Paldiski does not agree with the opinion of the National Audit Office regarding the transfer of apartments and payment of support, but the reply of the City Government does not specify the reasons for the disagreement.

According to its reply, the Paldiski Rehabilitation Centre Foundation has started eliminating the deficiencies indicated in the audit report.

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