National Audit Office's opinion on the annual accounts 2009 of Baltic Defence College

Report of the National Audit Office for the
Commondat of the Baltic Defence College
and the Ministerial Committee
Tallinn, 11 November 2010

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Summary of audit results

What did we audit?

The National Audit Office has assumed an obligation to audit annual accounts of the Baltic Defence College and has done that since 2000. The National Audit Office audited the accuracy of the annual accounts 2009 of the Baltic Defence College. Furthermore, the National Audit Office also reviewed whether the College has a functioning internal control system in place that provides conditions for the purposeful use of money allocated to it.

The profit of the College for 2009 amounted to 9.2 million kroons, with a balance sheet total as of 31.12.2009 of 23 million kroons.

What did we find and conclude based on the audit?

The main conclusions of the National Audit Office are the following:

- The annual accounts 2009 of the Baltic Defence College give a true view of the College's financial status and performance results in all material respects.
- Regardless of the observations and recommendations made earlier by the National Audit Office the use of the budget is still not always purposeful and transparent and there are still shortcomings in the internal control system of the College.
- The basis for recording and budgeting expenses have not been determined all-inclusively and unambiguously and this has resulted in inaccuracies in accounting and reduced the transparency of the budget.
- Similarly to previous periods there have been delays in applying for a refund of value added tax.
- In the complicated economic environment the College has not used the money allocated by the Republic of Estonia economically.

Table of Contents

Accuracy of the annual accounts 2009 of the Baltic Defence College

Accuracy of the annual accounts

The annual accounts are accurate in all material respects

1. The National Audit Office is of the opinion that **the annual accounts of the Baltic Defence College** according to which the profit of the College for 2009 amounts to **9 168 968** kroons, with a balance sheet total as of 31.12.2009 of **22 962 058** kroons, give a true and fair view of the College's financial position and performance and its cash flows for the financial year then ended in all material respects.

There are shortcomings in the organisation of accounting and the functioning of the internal control system

2. Sections 3–14 set out the observations made during the audit about the accounting and the internal control system, which do not affect the opinion of the National Audit Office, but which refer to shortcomings in the organisation of accounting and the functioning of the internal control system and may result in significant errors in the annual accounts if the organisation of accounting is improved.

Functioning of internal control system

Errors are still made in confirming transactions and recording expenses and revenue

3. During the audit the National Audit Office found several yearly recurring deficiencies in the functioning of the internal control system and organisation of accounting. For example:

- The requirements established for incurring expenses are too general and do not ensure purposeful use of the budget: economic expenses may be incurred by all employees, guest lecturers, students, etc., of the College when necessary and no limits have been determined. To incur economic expenses, employees may use personal money, which will be compensated to them later and, if necessary, advance payment (except students) may be received. No limits have been established on economic expenses for a certain period (e.g. as regards spectacles, fuel, telephone expenses, etc.).
- The Commandant of the College approves the budgetary items of expenses to be marked in source documents but the items have been modified in source documents and in the accounting afterwards. No expense managers have been appointed and decisions on the adjustments are made solely by an accountant. The accounting policies and procedures do not lay down the Commandant's or an expense manager's obligation of and procedure for approval of the corrections in accounting or budgetary source.
- No budgetary resources have been planned for purchasing fixed assets. No limits have been established for the College as from which tenders must be taken from several tenderers.

- No consolidated records have been drawn up about the inventory check of receivables and liabilities, due to which it is not possible to make sure the all-inclusiveness of the inventory check.

- In December the overtime work hours were compensated without approving the calculation of the employee's overtime work. According to the explanations of the chief accountant the tables for calculation of overtime for December 2009 and January 2010 have not been submitted to the Accounting Department.

- A lot of mistakes have been made in the periodisation of revenue and expenses. For example the College has recorded under revenue for 2009 the amount of 156 466 kroons that had been received from the Ministry of Defence for two foreign students and from which it was planned to incur expenses in the following period. The expenses have been recorded according to the date on the invoice, regardless of the actual time of receipt of service. Some of the overtime work (approx. 30 hours) calculated in December 2009 has been paid out and recorded under expenses in January 2010.

- HNS (host-nation support) revenue of the second half of 2009 has been recorded on the basis of expenses as one consolidated entry in the amount of 1 427 832 kroons. It was not possible to make sure whether the recorded amount is accurate as the accountant did not present a detailed content of the accounting entry.

4. The National Audit Office is of the opinion that the aforementioned shortcomings in the internal control system do not provide the management with an overview of the expediency of the expenses incurred and may result in misrepresentations.

5. The National Audit Office's recommendations to the Commandant of the College:

- Appointment of expense managers who would check the purposeful use of the budget should be considered, limits should be established on economic expenses and adherence thereto should be ensured.

- Budgetary resources should also be planned for purchasing fixed assets and the minimum limit should be established as from which price offers should be asked from at least three undertakings.

- Revenue and expenses should be recorded in the period when the transactions are conducted and their compliance should be ensured.

Response from the Commandant of the College: The College is aware of the recommendations made by the National Audit Office and takes them into consideration, adding that:

- the procedure for incurring economic costs is reasonable considering the nature of the College's needs;

- budget planning for the acquisition of fixed assets depends on the demands of the College's financial year and, in so far as possible, three providers operating on the market are asked to submit their price offers;
- remuneration is calculated on the basis of the approved time calculation tables.

Classification of expenses

Expenses are not recorded based on the budget

6. In recording and budgeting expenses there are still no consistent and unambiguous rules for distributing them between accounts and budget items. For example:

- Expenses of similar content have been classified both as expenses of the targeted financing of the host-nation support as well as the operating expenses of the College.
- Overhead expenses have not been distributed to all students equally and the recording of expenses as the student expenses only is not always justified (e.g. the goods or services received are also used by employees of the College).

7. **The National Audit Office's recommendation to the Commandant of the College:** it should be determined on which principle expenses are classified into operating expenses and expenses of targeted financing and the consistent implementation of the established principle should be ensured.

Response from the Commandant of the College: The College is aware of the recommendations made by the National Audit Office and takes them into consideration, adding that the costs related to targeted financing can be identical to operating costs since the support is provided by the recipient country.

Refund of value added tax

There have been delays in applying for a refund of value added tax

8. The College receives a refund of value added tax on expenses exceeding 1 000 kroons (incl. expenses subject to targeted financing) that it pays back to the state budgets of the Baltic countries. Like last year, refund of value added tax has not been applied for on time. The audited source documents of economic expenses include purchase invoices within at least 50 000 kroons on which no refund of value added tax has been received. The failure to apply for a refund of value added tax was substantiated by being on holiday.

Response from the Commandant of the College: The College agrees with the opinion of the National Audit Office and takes it into consideration. As regards the reason provided by the National Audit Office, we would like to add that the receipt of invoices may also occur after the deadline of an application.

Revenue and expenses of targeted financing are not in compliance

Compliance between revenue and expenses

9. In most cases the revenue of targeted financing has been recorded with value added tax, which is generally refunded to the College and repaid by the College to the Baltic countries. However, the expenses corresponding to the revenue have been recorded without value added tax. In such manner revenue has been recorded within at least 34 000 kroons. The National Audit Office is of the opinion that recording revenue of targeted financing with value added tax in the College's accounting is not justified because the refunded value added tax is subject to retransfer to the budgets of the countries is not the revenue of the College.

10. **The National Audit Office's recommendation to the Commandant of the College:** the principles of accounting revenue should be specified in the accounting policies and procedures.

Response from the Commandant of the College: The College agrees with the opinion of the National Audit Office and takes it into consideration.

Making prepayments

The College has made prepayments without explaining their purpose

11. Within the year the College has paid prepayment invoices without an aim agreed on in advance. For example, prepayments made to a travel agency in July 2009 in the amount of 300 000 kroons and in December in the amount of 75 000 kroons have not been provided with any explanations. The flights prepaid in December 2009 took place in April 2010. In December 2009, 220 000 kroons have been paid for books that were received in 2010. The National Audit Office is of the opinion that this refers to the wish to fully spend the budget of 2009.

12. **The National Audit Office's recommendation to the Commandant of the College:** agreements that presume prepayments in large amounts should be avoided.

Response from the Commandant of the College: The College is aware of the recommendations made by the National Audit Office and takes them into consideration, adding that in some cases, advance payments for services that the College needs on a regular basis (e.g. reservations for seminars, conferences and other major events, publications, etc.) are still necessary.

Purposeful use of budgetary resources

The College has not always acted in the most economically purposeful manner

13. In previous years the National Audit Office has made observations about inexpedient use of money. When auditing the accounts for 2009, the National Audit Office also found that the College has organised two trips from the HNS budget. The first of these was a ski trip for selected students and teaching staff and their children to Norway (the total cost 145 457 kroons) and another for AICSC (Army Intermediate Command and Staff Course) students, teaching staff and their children to Finland (in the amount of 122 096 kroons). The National Audit Office does not consider incurring such expenses justified or economical. During the audit the National Audit Office could not find any connection between these trips and the educational activities of the College.

Response from the Commandant of the College: The expenses covered from the budget of HNS have been substantially related to the activities of the College, with provision of education being one of our principal activities. Considering the economic environment and general background of the College, some expenses may appear to be less important than the others but are nevertheless justified.

Response from the Minister of Defence: The Ministry of Defence of Estonia will conduct an investigation concerning the case pointed out in Section 13 to find out whether the HNS budget transferred to the Baltic Defence College by the Ministry of Defence of Estonia has been used according to the Memorandum of Agreement between the Ministry and the College.

Acquisition of assets

Assets acquired under finance lease have not been recorded correctly

14. In two cases the College has acquired assets under finance lease, which was initially not recorded in the balance sheet as of 31.12.2009 under assets and liabilities. In one case (acquisition of a minibus) the accounting was amended during the audit, but the College has also rented a Canon photocopier at an acquisition cost of 239 236 kroons. The National Audit Office is of the opinion that this transaction should be recorded as a finance lease as the term of lease covers useful life and rent charges exceed the acquisition cost.

15. The National Audit Office's recommendation to the Commandant of the College: in the future lease contracts should be recorded according to their economic content.

Response from the Commandant of the College: The College agrees with the opinion of the National Audit Office and takes it into consideration.

/Signed digitally/

Ines Metsalu
Head of Financial Audit Department

National Audit Office's recommendations and responses from Commandant of Baltic Defence College and Minister of Defence

As a result of the audit, the National Audit Office made to the Commandant of the College several recommendations. On the 2nd of November 2010 the Commandant sent his response to the draft audit report of the National Audit Office. Additionally, the National Audit Office provided the Minister of Defence of Estonia the results of the audit. On the 8th of November the Minister of Defence sent his response to the draft audit report.

General comments of Minister of Defence on the audit report
The Ministry of Defence of Estonia agrees with the recommendations presented in the National Audit Office's report and watches closely the implementation of these recommendations by the Baltic Defence College. I would also like to notify that the Baltic Defence College's structure has been reorganised (position of the Director of Support has been established), which makes the management of the support structures more transparent. The Ministry of Defence of Estonia has also informed Brig. Gen. Meelis Kiili, the Commandant of the Baltic Defence College starting from the 1st of January 2011, about the recommendations presented in the audit report. I thank the National Audit Office for continuing support in improving the internal control measures of the Baltic Defence College.

National Audit Office's recommendations	Responses from Commandant of Baltic Defence College
Functioning of internal control system 5. The National Audit Office's recommendations to the Commandant of the College: ▪ Appointment of expense managers who would check the purposeful use of the budget should be considered, limits should be established on economic expenses and adherence thereto should be ensured. ▪ Budgetary resources should also be planned for purchasing fixed assets and the minimum limit should be established as from which price offers should be asked from at least three undertakings. ▪ Revenue and expenses should be recorded in the period when the transactions are conducted and their compliance should be ensured. (sec. 3–4)	**Response from the Commandant of the College:** The College is aware of the recommendations made by the National Audit Office and takes them into consideration, adding that: ▪ the procedure for incurring economic costs is reasonable considering the nature of the College's needs; ▪ budget planning for the acquisition of fixed assets depends on the demands of the College's financial year and, in so far as possible, three providers operating on the market are asked to submit their price offers; ▪ remuneration is calculated on the basis of the approved time calculation tables.
Classification of expenses 7. The National Audit Office's recommendation to the Commandant of the College: it should be determined on which principle expenses are classified into operating expenses and expenses of targeted financing and the consistent implementation of the established principle should be ensured. (sec. 6)	**Response from the Commandant of the College:** The College is aware of the recommendations made by the National Audit Office and takes them into consideration, adding that the costs related to targeted financing can be identical to operating costs since the support is provided by the recipient country.
Compliance between revenue and expenses 10. The National Audit Office's recommendation to the Commandant of the College: the principles of accounting revenue should be specified in the accounting policies and procedures. (sec. 9)	**Response from the Commandant of the College:** The College agrees with the opinion of the National Audit Office and takes it into consideration.

Making prepayments 12. The National Audit Office's recommendation to the Commandant of the College: agreements that presume prepayments in large amounts should be avoided. (sec. 11)	**Response from the Commandant of the College:** The College is aware of the recommendations made by the National Audit Office and takes them into consideration, adding that in some cases, advance payments for services that the College needs on a regular basis (e.g. reservations for seminars, conferences and other major events, publications, etc.) are still necessary.
Acquisition of assets 15. The National Audit Office's recommendation to the Commandant of the College: in the future lease contracts should be recorded according to their economic content. (sec. 14)	**Response from the Commandant of the College:** The College agrees with the opinion of the National Audit Office and takes it into consideration.

Overview of Baltic Defence College

The Baltic Defence College has been established on the basis of an agreement concluded between the Government of the Republic of Estonia, the Government of the Republic of Latvia and the Government of the Republic of Lithuania on 12 June 1998. The main aims of the College are to increase the interoperability of the countries through improving the training of staff officers and leading the personnel of the Defence Forces and the Ministries of Defence, support the development of the staff officers' corps and contribute to further introduction of democratic management principles in the armed forces and development of national concepts of total defence.

The financing, accounting and auditing principles of the College have been laid down in the Memorandum of Understanding concluded by the Baltic countries. Proceeding from the Memorandum, the College organises its accounting according to legislation of the Republic of Estonia, a more detailed specification and supplementation of the accounting is provided in the accounting policies and procedures of the College.

The persons responsible for drawing up the accounts and for accuracy of the information therein are the head of the College, Gundars Abols (the Commandant of the College since 14 December 2007), and chief accountant Jana Lundblad.

Characterisation of the audit

The National Audit Office has audited the annual accounts of the Baltic Defence College since 2001.

Observations made in the report are findings which due to the irrelevance of the amounts and the circumstances related to the appearance thereof did not affect the opinion of the National Audit Office as regards the accuracy of the annual accounts, but which could result in significant errors in the annual accounts or legality of transactions in the case of different conditions.

The report does not include minor audit findings whose impact is not significant. The attention of the auditee was brought to the need to remove such shortcomings during the audit.

Purpose of the audit

The purpose of the audit is to express an opinion about the accuracy of the annual accounts 2009 of the Baltic Defence College. The annual accounts of the College consist of the balance sheet as of 31.12.2009, income statement, cash flow statement and statement of changes in owners' equity for the financial year, a summary of the accounting policies and procedures used in preparing the annual accounts and other explanatory notes.

Assessment criteria

In expressing its opinion on the annual accounts, the National Audit Office relied on the following criteria:

- the assets and liabilities exist as of 31.12.2009;
- the assets and liabilities belong to the Baltic Defence College as of 31.12.2009;
- the transactions were conducted or the events took place in 2009;
- all assets, liabilities, transactions and events have been recorded and the indicators have been disclosed;
- the assets and liabilities have been recorded in the correct book value;

- the transactions or events have been recorded in the correct amount and the revenue and expenses have been entered in the correct period;
- the indicators have been disclosed, classified and described in accordance with the generally accepted accounting principles;
- the numerical information arising from the annual accounts and specified in the management report has been recorded in correct amounts.

Scope and focus of audit

In providing an assessment of the accuracy of the annual accounts 2009 of the Baltic Defence College the National Audit Office assessed the compliance of the annual accounts with the accounting principles generally accepted in Estonia, the Accounting Act and relevant regulations of the Minister of Finance.

The National Audit Office performed the audit in accordance with the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI). These standards require that an audit be planned and performed in a manner that allows the financial statements to be decided with sufficient assurance that they are free of material misstatements. During the audit evidence was collected about the numeric data presented and information disclosed in the annual accounts. To plan relevant audit operations, the National Audit Office took into account the internal control system introduced to draw up and present true and fair annual accounts, but not in order to express an opinion on the efficiency of the internal audit. During the audit the relevance of the used accounting principles, the justification of the accounting assessments made by the management and the general manner of presentation of the annual accounts was also assessed. The National Audit Office is of the opinion that the audit provides a sufficient basis for expressing an opinion on the annual accounts.

Time of completion of audit

The audit was completed in September 2010.

Audit team

The audit team consisted of senior auditors Jaana Tael and Eeli Lääne.

Contact information

For additional information on the audit, please refer to the Communication Services of the National Audit Office: phone +372 640 0704 or +372 640 0777, e-mail riigikontroll@riigikontroll.ee

An electronic copy of the audit report (PDF) is available at www.riigikontroll.ee.

The audit report is also available in Estonian.

The number of the draft audit report in the record management system of the National Audit Office is 2-1.8/10/60025/8.

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Previous financial audits conducted by National Audit Office in Baltic Defence College

16.09.2009 – **National Audit Office's opinion on the annual accounts 2008 of the Baltic Defence College**

25.09.2008 – **National Audit Office's opinion on the annual accounts 2007 of the Baltic Defence College**

22.08.2007 – **National Audit Office's opinion on the annual accounts 2006 of the Baltic Defence College**

24.08.2006 – **National Audit Office's opinion on the annual accounts 2005 of the Baltic Defence College**

10.08.2005 – **National Audit Office's opinion on the annual accounts 2004 of the Baltic Defence College**

02.08.2004 – **Follow-up audit of the annual accounts 2003 of the Baltic Defence College**

28.04.2003 – **Audit of the annual accounts 2002 of the Baltic Defence College**

24.05.2002 – **National Audit Office's opinion on the annual accounts 2001 of the Baltic Defence College**

05.06.2001 – **Economic activities of the Baltic Defence College in 2000**

All reports are available on the website of the National Audit Office at www.riigikontroll.ee.