

Accuracy of Annual Report 2013 and regularity of transactions of the state

Report of the National Audit Office to the
Riigikogu

Tallinn, 12 August 2014

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Summary of audit results

What did we audit?

Every year the National Audit Office audits the state's annual accounts as well as the annual accounts of ministries, the Government Office and constitutional institutions. In addition to this the National Audit Office checks whether state agencies have performed their economic transactions in compliance with the most important legislation: the State Budget Acts, the State Assets Act and the Public Procurement Act. The National Audit Office also expresses an opinion as to whether the budget acts have been adhered to in the performance of economic transactions. The most significant observations about omissions found in transactions with state assets and public procurements are highlighted in the audit reports.

What was the scope of our audit?

The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency in addition to the indicators of state accounting entities. The National Audit Office does not audit the annual accounts of these entities, but considers the opinion of certified auditors when expressing an opinion on the state's annual accounts.

Nor did the National Audit Office carry out audit procedures to check additional information (annual accounts) about local authorities, the public sector and the government sector disclosed in the Consolidated Annual Report of the State.

Why is this important to taxpayers?

By auditing the state's annual accounts the National Audit Office provides assurance that the accounting indicators presented to the Riigikogu and the public give true information about the state's financial position and performance results for the year ended and that the State Budget Execution Report gives relevant information about the state's revenue and expenditure and investments made at the account of this revenue.

According to the 2013 State Budget Execution Report, the revenue collected by the state in 2013 amounted to 7.7 billion euros, which exceeded the revenue of 2012 by 1.3 billion euros. The expenditure and investments incurred by the state amounted to 7.6 billion euros, which exceeded the expenditure of 2012 by 1.1 billion euros. The increase in revenue and expenditure is due to a change in presentation principles. The budget now recognizes taxes collected and transferred by the Tax and Customs Board (land tax, income tax, unemployment insurance premium to the Estonian Unemployment Insurance Fund) as revenue and expenditure, which was not previously recognized as revenue and expenditure in the state budget. In 2013 revenue exceeded expenditure by 30 million euros.

According to the consolidated annual accounts of the state, the assets of the state as of 31 December 2013 amounted to 12.5 billion euros and the majority of the assets are fixed assets. Compared to the previous period the value of assets has increased by 0.8 billion euros, mainly on the account of tangible fixed assets and an increase in receivables and prepayments. As at 31 December 2013 the state's liabilities totalled 5.5 billion euros - an increase of 0.5 billion euros compared to the previous period. Long-term liabilities comprise the majority of liabilities and the increase in them was mainly caused by the growth of long-term loans payable.

**What did we find and
conclude based on the audit?**

The 2013 Annual Accounts of the State are correct in all material respects, which means that they give a true and fair view of the state's financial position as well as its financial performance and cash flow for the year ended.

The National Audit Office is of the opinion that the state's economic transactions were performed in all material respects in accordance with the State Budget Act, the 2013 State Budget Act and its amendment act. This means that the National Audit Office did not find any significant errors in the implementation of the State Budget Acts.

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

- **The State Budget Execution Report and the annual state budget can be compared.** Thanks to the amendments made to the presentation of the State Budget Act it is easier to compare the annual state budget and its execution report.
- **The amount of funds transferred in the state budget to the year 2014 is large (7% of budget expenditure) and not many explanations can be found in documents available to the public as to the reasons for the transfer.** Considering the transferred amount the National Audit Office is of the opinion that it is necessary to analyse and disclose the reasons for transfer so as to ensure transparency of the use of funds and more efficient budget planning.
- **Upon state budget planning and use there are still problems with capital lease contracts as agencies are not authorised to conclude said contracts.** The Ministry of Finance must also develop a solution for controlling the conclusion of capital lease contracts that cannot be terminated so that said contracts would not restrict budgeting decisions and affect the state's debt obligations.
- **Upon the acquisition of goods and services state agencies generally adhere to the requirements of the Public Procurement Act. The auditors still found certain shortcomings:** unperformed procurement procedures, especially in terms of simplified procurements, mistakes in selecting the type for procurement procedure, problems with submitting procurement reports. However, state agencies have improved their procurement procedures and plans, the shortcomings in which had been pointed out by the National Audit Office in the previous year.
- **The purpose for state participation in foundations has not always been clearly identified and the rules for allocating funds for**

foundations are in need of specification. The National Audit Office found that upon the establishment of foundations it is often not clearly stated why it has been decided to provide public services through state participation in the foundation. Allocation of funds to foundations is sometimes unclear or carried out while violating the law, thus making it difficult to get an overview of the procedure.

- **Transferring state assets to Riigi Kinnisvara AS has caused a considerable increase in rent expenses of state agencies, which will increase the burden on the state budget.** At the same time it is unclear where the funds required to cover the increase in rent prices will be found. In the survey commissioned by the Ministry of Finance the experts proposed to abandon market-based rent payments for certain objects owned by the state and use cost-oriented rent instead.
- **The centralisation of accounting and the introduction of single accounting software have improved the level of accounting in the areas of government of most ministries.**
- **Reporting of state accounting entities can be made more efficient.** The National Audit Office is of the opinion that the annual reports prepared by the ministries are not used. From the perspective of the Riigikogu, the Government and the public, the consolidated report of the state is more important. Therefore it would be reasonable to simplify the content requirements for the annual reports of state accounting entities so as to save working time currently spent on the preparation and auditing of said reports.

What did we recommend as a result of the audit?

Important recommendations of the National Audit Office to the Minister of Finance:

- During budget planning regulate the treatment of rent transactions so as to comply with the State Budget Act.
- In order to ensure the transparency of budget discipline and budget planning, analyse the substance of the transfer of funds when preparing the budget execution report, and disclose it during the preparation of the Consolidated Annual Report of the State or the budget for the next period.
- Consider the proposals given by the experts who compared lease contracts to market conditions, and find an optimal model for determining rent for spaces for which it is not possible to carry out market comparison.
- Pay more attention to the ministries' organisation of simplified procurements.
- Simplify the requirements for the reporting of state accounting entities to ensure sufficient data for the preparation of consolidated report of the state and financial statistics of the government sector, and make reporting of the results of financial year more efficient.

The Minister of Finance agreed with the proposals of the National Audit Office.

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Opinion on the regularity of transactions in 2013

Regularity of transactions

The State Budget Acts have been observed

1. According to the 2013 State Budget Execution Report, the revenue collected by the state in 2013 amounted to 7.67 billion euros, expenditure incurred by the state amounted to 7.34 billion euros and investments to 0.3 billion euros. The National Audit Office is of the opinion that the state's economic transactions were performed in all material respects in accordance with the State Budget Act, the 2013 State Budget Act and its amendment act.

The manner of presentation of the State Budget Execution Report has improved

2. In the audit reports for previous years the National Audit Office has drawn attention to the fact that the manner of presentation of the state budget makes it impossible to understand and does not observe the manner of presentation of the state budget adopted by the Riigikogu. According to International Public Sector Accounting Standard IPSAS 24 "Presentation of Budget Information in Financial Statements", the budget adopted by the parliament, the final budget and the data of actual execution of the budget must be presented in a manner that is comparable to the adopted budget so as to increase the transparency of the financial statements of the public sector.

The manner of presentation of the State Budget Act has been amended

3. The 2013 state budget was approved by the Riigikogu in a new format, and the same manner of presentation has been used for reporting on the execution of the state budget. Thus the state budget approved by the Riigikogu and the State Budget Execution Report can now be compared and the principle established with international standards is observed.

4. However, compared to the general accounting principle, at least one exception maintains to which the National Audit Office drew attention in the 2012 audit report.

- In the 2012 State Budget Execution Report the revenue generated by environmental charges were shown as revenue of the Ministry of Finance although such revenue was planned in the budget of the Ministry of the Environment and recognised in the annual accounts of the Ministry of the Environment. This is why the state budget and the State Budget Execution Report could not be compared in this respect.

Environmental charges – According to the 2013 consolidated report the state's revenue from pollution quotas and for granting use of natural resources amounted to 35.8 million euros.

In 2013 the revenue generated by **environmental charges** was planned in the budget of the Ministry of Finance and this made the comparison of the state budget and the State Budget Execution Report possible. However, the revenue generated by environmental charges continue to be recognised in the accounting of the Ministry of the Environment which means that transactions recognised in the annual accounts of the Ministry of the Environment and the budget execution report.

The amount of expenditure transferred to the next year is large

5. The National Audit Office is still of the opinion that the same entity must be treated as the performer of an economic transaction in both the annual accounts and the budget execution report.

The amount of transferred expenditure is large but the need for their transfer has not been sufficiently analysed

6. The State Budget Execution Report informs the Riigikogu and the general public of the amount of funds used by the government in the course of the year and of the amount of funds transferred to the next fiscal year. In its previous audits the National Audit Office has criticised the inadequacy of information regarding the transferred expenditure.

7. The last column of the 2013 State Budget Execution Report shows the amount of funds, planned for investments and expenditure, was transferred at the end of the year. 536 million euros were transferred from the 2013 budget to the year 2014 (7 per cent of the actual expenditure in 2013), 479 million euros were transferred from the 2012 budget to the year 2013, and 431 million euros were transferred from the 2011 budget to the 2012 budget. General reasons for the transfer of expenditure may include the delay in investment projects, failure to terminate projects financed from the EU funds by deadline, etc.

8. Unfortunately the reasons behind the transfer of expenses for the areas of government of each ministry still remain unclear for the reader of the consolidated annual accounts of the state. Explanations for the transfer of funds are not always included in the ministries' annual reports, and this information is not aggregated in the consolidated annual accounts of the state or during the preparation of the state budget. Considering the large amount of transferred funds the National Audit Office feels that it is necessary to analyse and disclose the reasons for transfer so as to ensure transparency of the use of funds and more efficient budget planning.

9. The National Audit Office is of the opinion that the large amount of funds transferred from the previous year indicates that budget planning is not efficient enough and that determination of expenditure does not consider the actual capacity for using said funds. This, however, may lead to impractical expenses.

Unjustified prepayments are made at the end of year

Restrictions on transferring funds from the state budget to the next year have been determined as follows with the State Budget Act:

- expenditure that depends on revenue may be transferred to the extent of the amounts that have been received but not used;
- the extent of expenditure with limits that may be transferred is 3% of the budget if not otherwise established in the annual state budget;
- investments, foreign support and co-financing of the state may be transferred in full amount;

6 financing transactions will not be transferred.

10. As the State Budget Act establishes [restrictions](#) for expenditure transferred into the next year, this may lead to a situation where prepayments will be made for future expenditure at the end of year so as to prevent losing the funds. The National Audit Office has identified cases where the prepayment was not essential and thus budget funds were used inexpediently.

11. For example, the National Audit Office does not find the prepayment of the Ministry of Education and Research to the Riigi Kinnisvara AS (hereinafter RKAS) to be justified.

- At the end of December 2013 the Ministry of Education and Research made to RKAS a prepayment of 2.2 million euros (with VAT) pursuant to the contract concluded on 13 December 2013 for the organisation of procurement for the reorganisation of school network and the provision of project management service. It was agreed in the contract that the specific terms of the provision of service, including

the rights and obligations of the parties, will be agreed in separately concluded contracts. Such contracts were not submitted to the National Audit Office in the course of the audit (as at the end of May 2014).

As the contract concluded between the ministry and RKAS did not specify the deadline and specific terms for the provision of service, the National Audit Office finds that the prepayment to RKAS with the intention of using the 2013 budget funds was not justified and did not comply with the General Rules of State Accountancy. As a substantial proportion of the agreed activities were investments by nature, the allocation of the prepayment from management expenses was not in compliance with the State Budget Act. Likewise, it is questionable whether a prepayment to a state company is necessary for project management and the organisation of procurement.

12. Recommendation of the National Audit Office to the Minister of Finance: In order to ensure budget discipline and the transparency of budget planning, analyse the substance of the transfer of funds when preparing the budget execution report, and disclose it during the preparation of the Consolidated Annual Report of the State or the budget for the next period.

Response of the Minister of Finance: When transferring state budget expenditure we have assessed the regularity and compiled a list of reasons why said funds were not used in the financial year. We will consider the recommendation to disclose the reasons. The State Budget Act authorises the Minister of Finance to establish the procedure for the transfer of state budget funds. We will update the procedure for the state budget strategy and state budget preparation. During the preparation of said regulations we will consider the opportunity to use the reasons for transfer more than before for preparing the decisions made during the preparation of the state budget strategy and state budget.

There are some errors in the planning and use of the agencies' budget

13. The National Audit Office finds that the planning and use of budgets in the ministries and the agencies in their areas of government is generally at a good level. The National Audit Office identified only some errors where the state agencies have made investments from the funds intended for management expenses and allocated management expenses from the funds intended for investments. Similarly to the audits of the previous years the 2013 financial audits carried out by the National Audit Office indicated that agencies continue to err against the principles of the State Budget Act, mostly when entering into long-term lease contracts. This topic is further addressed in Articles 18–24.

Expenditure has been inaccurately calculated in the Government Office

14. Although several errors in budget use, identified by the National Audit Office, were eliminated during the year with budgetary adjustments, there was a case where the National Audit Office and the audited entity were of different opinions.

- The Government Office applied for 740,000 euros for the organisation of events dedicated to the 95th anniversary of the Republic of Estonia, of which 73,000 euros for subsidies and 667,000 euros for management expenses. This amount was allocated by the

Riigikogu. The Government Office used the funds expediently for the activities related to the 95th anniversary of the Republic of Estonia.

Did you know that

if a state agency grants a subsidy to another state agency, this will be recognised as a [cash transfer](#) in the budget and in accounting.

As a subsidy for the anniversary the Government Office gave 323,933 euros to the Ministry of Culture and 50,000 euros to the Ministry of Education and Research from the funds intended for management expenses although the budget did not include the grant of subsidies as a [cash transfer](#) in this extent. An additional 80,000 euros from the funds intended for management expenses were paid to Estonian Film Institute, Estonian National Opera and Estonian Public Broadcasting.

The National Audit Office feels that the cases in question describe the grant of subsidies from the funds intended for management expenses as the Government Office did not receive any goods or services in return for said funds. The following circumstances also refer to the grant of a subsidy: recipients of funds have treated the funds received from the Government Office as a subsidy, the Government Office did not organise procurements for the use of these funds and none of the recipients of funds have submitted to the Government Office an invoice for the provision of services. Granting of subsidies from the funds allocated for management expenses is not in compliance with the State Budget Act.

15. In its audits the National Audit Office has emphasised that if there arises a need during the financial year for the expenditure to be used differently from what has been planned, an application for the amendment of the budget should be submitted in order to ensure the clarity and comparability of budget reporting. This has generally been the case.

The new State Budget Act that entered into force in 2014 did not eliminate the problems concerning long-term lease contracts

Execution of budget

16. In the summer of 2013 the Ministry of Finance submitted for a approval a new Draft State Budget Act. The objective of proposing a new act was to establish legal bases and general requirements to ensure the long-term sustainability of the Estonian economy and finance. According to the explanatory memorandum of the draft the act will stipulate bases for the preparation of the state budget so that the opportunities arising from public finance forecast, objectives and needs related to the policies of respective domains, specified in strategic development documents, and the state budget strategy comprising of the above, would be taken into consideration upon the preparation of the state budget.

17. The National Audit Office has given an opinion on the draft versions several times, with the main listed shortcomings including the inadequate role of the Riigikogu in strategic planning, poor clarity of the requirements for the manner of presentation of the State Budget Act and State Budget Execution Report, lack of requirements for management reports, etc. The State Assets Act was adopted by the Riigikogu in February 2014. By the time of the audit the new act had not yet been implemented for such a period that would have enabled to assess whether the objectives set with the new act had been achieved. However, the National Audit Offices wishes to draw attention to the topic that remains ambiguous in the new act.

Budgeting of lease contracts

18. For years the National Audit Office has pointed out the fact that the ban on capital lease transactions, implemented with the State Assets Act, except for cases when said transactions are allowed by the annual State Budget Act approved by the Riigikogu, is ambiguous and in need of specification.

19. The State Budget Act stipulates that state agencies must not take loans, use capital lease and assume other long-term commitments unless these have been prescribed in the annual state budget. Therefore, if an agency wishes to carry out capital lease transactions; these should be prescribed as financing transactions in the annual budget planning. The National Audit Office draws attention to the fact that when defining the term “capital lease” in the guidelines on the use of the budget classification, prepared in 2013, the Ministry of Finance referred to guideline No. 9 “Calculation of Rent” of the Accounting Standards Board.

20. The audits of the National Audit Office have shown that state agencies rent vehicles, office furniture and computers for performing their main activities. Below there are examples of the most common types of lease contracts concluded by the ministries, which are in violation with the State Budget Act or can be interpreted ambiguously.

- **Contracts that according to the guideline of the Accounting Standards Board must be deemed as capital lease contracts.** In several lease contracts the National Audit Office identified paragraphs that clearly refer to capital lease. For example, rent instalments form over 90% of the value of rented property and/or the contractual terms stipulate that risks related to ownership are mostly the responsibility of the lessee.

Agencies have regarded these contracts as capital lease contracts and recognised them as such in accounting. However, the budget does not include funds planned for financing transactions and these have been paid from the budget of both investments and management expenses.

- **Long-term operating lease contracts that cannot be terminated.** The National Audit Office has also identified that the agencies continue to conclude lease contracts for which it is questionable whether they concern capital lease or not, but on the basis of contractual terms it is clear that the state agency cannot terminate said contracts prematurely without making all lease payments to the lessor and covering other expenses, or, for instance, compensating the damages arising from the sale of property.

The National Audit Office is of the opinion that such contractual terms indicate that in the context of the State Budget Act the agencies have assumed long-term commitments for which the law requires them to have the authorisation of the Riigikogu. The sums used for the conclusion of such lease contracts and payment of commitments are generally planned as management expenditure in the state budget. The ministries regard such contracts as operating lease that cannot be terminated and recognise them as operating lease in their accounting.

21. Although the wish and practice of the management of agencies has been such that they wish to enter into new operating lease contracts that

they do not intend to terminate prematurely, the National Audit Office is of the opinion that the entry into contracts with restricting terms is a risk and that in the case of a stressful state budget when it is necessary to significantly decrease expenses, these contracts cannot be terminated without additional expenses that must be allocated from the state budget. For example, according to Note a30 D to the Consolidated Annual Accounts of the State as at the end of 2013, the operating lease commitments that cannot be terminated amounted to 378.9 million euros (unconsolidated data).

22. To comply with the State Budget Act the Ministry of Finance has to ensure that the agencies, for the purposes of guideline No. 9 of the Accounting Standards Board, plan all transactions that correspond to the conditions of capital lease as financing transactions. The agencies should also pay attention to the fact that other lease contracts must not include unfavourable terms (e.g. a fine in case of termination, covering damages from the sale of property, responsibility for outstanding payments, and long term of advance notice of termination). The Ministry of Finance must develop a solution to help control the entry into new lease contracts that cannot be terminated so that such contracts would not restrict budgeting decisions.

23. The National Audit Office is of the opinion that establishment of a common practice for capital lease and operating lease is important because differentiating between these transactions has an impact on the state's debt burden.

24. Recommendation of the National Audit Office to the Minister of Finance: during budget planning regulate the treatment of rent transactions so as to comply with the State Budget Act and consider the principles of preparation of the financial statistics of the state.

Response of the Minister of Finance: To increase the clarity of regulation we will replace the directive of the Minister of Finance that regulated the preparation of the budget up until now with a new respective regulation. To implement the new State Budget Act we are preparing a new regulation of the Minister of Finance "State budgeting strategy and procedure for preparing the budget project in the area of government of the ministry". The Draft regulation includes a provision which indicates that upon determining the nature of a capital lease and operating lease contract, guideline No. 9 of the Accounting Standards Board must be observed.

To get an overview of lease contracts that cannot be terminated we will improve the requirements on data collection included in the regulations governing the preparation of the state budget so as to provide a better overview in the annual explanatory memorandum of the State Budget Act of current and future lease contracts that cannot be terminated. The overview will help control the entry into new lease contracts that cannot be terminated.

The rules for allocating funds to foundations from the state budget are unclear

25. In 2013 the National Audit Office audited how support was granted from the state budget to foundations established by the state and the

expediency of the use of said support. The audit assessed whether the manner of granting support to foundations established by the state was clear and transparent, whether the ministries have established a control system for granting support and performing supervision over the use of granted support. In the foundations selected for auditing the auditors assessed the manner of organisation of the use of funds received from the state budget, whether received funds were used in an expedient and legitimate manner, and whether the selection of foundation as a legal form has been justified upon the establishment of the foundation.

26. The main observations of the audit were as follows: there is no established practice to determine when the state will select foundation as a legal form, and how the foundation is funded. The ministries' supervision over the activities of foundations tends to be formal. However, the audit revealed that the foundations have fulfilled objectives specified in the articles of association and generally used the funds received from the state in an expedient manner.

27. The audit report is available on the website of the National Audit Office and this report only addresses two problems related to the state budget. Firstly, the funding of certain foundations from the state budget is still unclear. Secondly, the National Audit Office disapproves of the practice of funding the ministries' main activities on the account of foundations.

Financing foundations from the state budget

28. Financing foundations from the state budget needs to be made more transparent. It is difficult to understand from the State Assets Act and its explanatory memorandum how much money will be allocated to foundations. While the explanatory memorandum of the State Assets Act includes a table on support allocated from the state budget, it does not contain all amounts allocated for support as they have not been submitted or are shown in other tables. Therefore, it is easy to notice that in the explanatory memorandum of the 2013 State Assets Act the support allocated to foundations amounted to 62 million euros whereas the final budget for the year 2013 was 127 million (does not include EU support mediated by several foundations).

29. As the foundations are engaged in fulfilling very different objectives, it is clear that a common financing model for all foundations cannot be established. However, the audit identified problems with compliance with current rules as well as with the ambiguity of rules.

- **After the increase in environmental charges the financing of the Environmental Investment Centre was left unorganised.** An example of unclear financing is the allocation of funds to the Environmental Investment Centre (hereinafter EIC). Since 2010 when the revenue base of the state budget was increased at the account of environmental charges, the environmental charges collected pursuant to the Environmental Charges Act will be divided into three: funds allocated to local authorities, funds allocated to the EIC for specific purposes, and funds allocated to the state budget revenue without a specific purpose. The funds allocated to the EIC are entered in the state budget for the use of the environment and in the extent of environmental charges rates effective in 2009. Such allocation of funds reduces transparency and makes it complicated and time-consuming to get an overview of the funds allocated to the

EIC, as for each transaction of environmental charges a recalculation must be made pursuant to the rates effective in 2009 (each type of fee has a separate rate), multiplying it with the amount of environmental resources used for the transaction, and adding together the sums received as a result. The National Audit Office is of the opinion that instead of using invalid environmental charges rates, a specific amount of funds should be allocated to the EIC in the annual state budget.

Estimated ticket price is an indicator which is calculated, pursuant to the Performing Arts Institutions Act, on the basis of the location of the performing arts institution, data of Statistics Estonia on the average income of local residents, and the main target groups of visitors.

- **Financing of performing arts institutions is not clear.** Upon allocating subsidies to theatres the Ministry of Culture has failed to comply with the Performing Arts Institutions Act. Pursuant to the act, the subsidy shall be granted as a subsidy for a visitor of a performance or concert. This compensates the performing arts institution for the difference between the actual cost of servicing a visitor and the **estimated ticket price**. In reality the Ministry of Culture does not observe this act as the theatres' cost accounting (on the example of Russian Theatre) does not enable to receive data on the expenditure of performances necessary for the granting of subsidies. Nor has the ministry calculated the estimated ticket price which would serve as a basis for the compensation of the difference between the actual expenses and estimated ticket price. Although it has been years since the model for calculating subsidies approved by the law was deemed impracticable, the legislation has not been amended to even out the basis for the granting of subsidies and actual practice. Ambiguity in the rules of financing does not support the theatres in making long-term decisions and must be disapproved in the situation where national theatres are turned into foundations.

Financing main activities through foundations

30. In addition to the above, the foundations have become a source of financing for the ministries. This problem is the most serious and long-term between the Environmental Investment Centre (hereinafter EIC) and the Ministry of the Environment, but the Ministry of Education and Research has also financed its main activities through a foundation in its area of government.

- In 2012 a total of 7 million euros were allocated from the budget of an environmental programme through the EIC for financing the projects of the Ministry of the Environment and its divisions, and the ministry's own employees participate in project assessment. The Ministry of Education and Research had allocated 66,930 euros to Archimedes Foundation pursuant to a contract for the internal assessment of general education and organisation of counselling of the executors of project, which is an obligation imposed on the Ministry of Education and Research by the law. With the mediation of Archimedes the work transferred with the contract was carried out by the officials of the Ministry of Education and Research.

Considering the clarity of the State Assets Act, the National Audit Office disapproves of such financing of the ministries' main activities, as the funds needed for said activities are not recognised in the state budget as the ministry's operational expenditure, or provide a general overview of the amount of funds the ministry needs from the state budget for its activities. As is evident from the case of the Ministry of the Environment, it also increases unnecessary

administrative burden as the ministry and its divisions have to prepare project applications which the EIC must process.

31. The National Audit Office recommended to the Minister of the Environment and the Minister of Education and Research to plan the expenses necessary for the performance of duties imposed by the law as operational expenditure in the ministries' budgets. The National Audit Office also suggested that a specific proportion of received charges should be allocated in the Environmental Charges Act or a certain amount in the annual state budget for financing project applications in the EIC; to prepare a draft act to amend the act in cooperation with performing arts institutions, so as to establish a suitable and legal basis for financing performing arts institutions if the current legal organisation is not expedient.

Acquisition and use of assets

Organisation of the acquisition and use of state assets is generally at a good level

32. In addition to expressing an opinion on adherence to the State Budget Act, the National Audit Office paid attention to adherence to the main principles of the Public Procurement Act and the State Assets Act when auditing regularity. The National Audit Office does not express an opinion on adherence with these laws and only presents the observations it made within the course of the audits.

33. In its audits the National Audit Office assesses whether the administrator of state assets has treated its assets prudently, i.e. considering the state's interests, in terms of both the disposal and use of state assets and participation in legal persons governed by private law. Assessing compliance with the principles of the State Assets Act is important as the book value of assets in the possession of the ministries was 9 billion euros (unconsolidated data) as at 31 December 2013 and 0.3 billion euros were used for investments from the 2013 budget.

34. Like in the previous year, the auditors from the National Audit Office participated in the stocktaking organised by ministries on a random basis. They reviewed the procedures that regulate stocktaking and the documents of the stocktaking organised at the end of 2012. The auditors also assessed the manner of acquisition, use, transfer and write-off of state assets and reviewed the amendments made into the contracts concerning state assets in 2013. In the audited cases the ministries had observed the principles of the State Assets Act, with the exception of the observations listed in Articles 37–59.

35. Compliance with the Public Procurement Act was also inspected in addition to adherence to the State Assets Act. The observations made about compliance with the Public Procurement Act are given in articles 60–67 of this audit report.

36. In the ministries' audits the National Audit Office noted several problems with the participation in legal persons governed by private law. For example, it is not clear what happens to the state agency's current assets and commitments if the state agency is reorganised as a foundation. It was also revealed that there is no proper overview of the non-profit associations in which the state agencies participate. Among other problems, the foundations audit carried out by the National Audit Office

identified that state participation in foundations may not always have clear objectives.

State participation in legal persons governed by private law is not always purposeful and overview of participation is poor

Establishment of foundations needs clear targets and principles

37. As at the end of the previous year, the state executed the rights of a founder in more than 70 foundations. According to the Foundations Act a foundation is established to administer and use assets to achieve the objectives specified in its articles of association. According to the State Assets Act and its explanatory memorandum, a foundation should be established for the execution of such public functions that are not directly related to the exercise of state authority and for which other form of activity is not suitable.

38. In its audit the National Audit Office examined whether, upon the establishment of foundations, attention is paid to whether it would be most prudent to carry out the planned activity through the form of foundation, assuming that sufficient information for making a decision will be submitted to the Government of the Republic on the positive and negative aspects of this legal form. Unfortunately the National Audit Office did not discover any evidence to confirm that the founders of audited foundations had comprehensively considered all alternatives and assessed the positive and negative aspects of the form of foundation. In general, the main reason for selecting foundation as form has been the opinion of the respective ministry.

39. For example, the Ministry of Culture has stated that the reason for the establishment of foundations lies in the increased right of independent decision-making in the established foundations, thus increasing the responsibility of the supervisory board and the management board, and that the supervisory board's options of controlling the founder will increase, while also increasing the opportunity for including additional funds. As an advantage of a foundation the ministry also mentions the option of cooperation with local authorities and local community, and inclusion of relevant specialists in the agency's work. The National Audit Office, however, feels that neither cooperation with specialists nor consideration of opinions of the local community are underlying reasons for the establishment of a foundation; it is something that can also be carried out in state authorities. Nor can bigger responsibility and control be considered as significant advantages for the establishment of a foundation. On the contrary, the establishment of a foundation makes management more complicated as instead of just one responsible person like in state agencies there are now several.

40. On the basis of the current situation it can be concluded that in nearly 20 years the state has failed to establish the best practice for using the form of foundation for the performance of public duties.

41. The National Audit Office recommended that the Minister of Finance in cooperation with the Minister of Justice analyse which public services should be provided through foundations, and explain whether and to what extent the established foundations perform said duties. The Minister of Finance agreed with the National Audit Office and promised to carry out the analysis in 2014 during the preparation of the consolidated report by including relevant agencies and disclose the results of the analysis in the

Green Paper of ownership policy of state agencies, developed pursuant to the action programme plan of the Government of the Republic.

42. The National Audit Office has identified a similar problem in respect of state companies. In 2013 National Audit Office carried out an audit titled "Organisation of management of public undertakings". In its audit report the National Audit Office stated that guiding the activities of state companies and owner supervision have not significantly improved in the past five years. Often the state has no idea why it maintains a certain company and what it expects from their activities. The state has failed to set clear objectives for companies and does not check their performance. Irrespective of this, several hundred millions of euros of tax-payers' money have been allocated to state companies.

State agency has become a member of non-profit associations without authorisation from the Government of the Republic

43. During an audit in the Ministry of Agriculture the National Audit Office identified that exercise of rights of a member in non-profit associations has not been in compliance with the State Assets Act. Namely, it was identified that the Estonian Crop Research Institute has been a member of several non-profit associations for years: Estonian Potato, Estonian Chamber of Agriculture and Commerce, Estonian Seed Association and Estonian Horticultural Association. However, the Government of the Republic has not named the Ministry of Agriculture as the exerciser of rights of member of these non-profit associations. As the State Assets Act stipulates that the state's rights of a member in non-profit associations may be exercised by a ministry appointed by the Government of the Republic, the National Audit Office finds that the Institute's membership in non-profit associations is a violation of the State Assets Act. The National Audit Office recommended to the Minister of Agriculture to determine the membership of agencies in the ministries' areas of government in non-profit associations and bring exercise of member rights in non-profit associations into conformity with the State Assets Act.

44. So far the Ministry of Agriculture has failed to report on the exercise of rights of a member in said non-profit associations in the manner required by the State Assets Act, which is why said associations have not been included in the consolidated report of public undertakings, foundations and non-profit associations prepared by the Ministry of Finance.

45. Thus the Riigikogu and the general public do not have any information on the non-profit associations the state agencies participate in, and whether their participation is justified.

Reorganisation of state agencies is not regulated

46. In the area of government of the Ministry of Culture several state agencies have been liquidated and replaced with foundations where the ministry exercises the rights of a founder. When assessing the establishment of foundations it was identified that the transfer of the remaining net assets (difference between current assets and commitments) of state agencies that have terminated their activities has not been properly recognised.

47. Namely, both the person transferring the assets and the recipient of assets have recognised the transfer as income and expenditure in their income statement (in the accounts for received and granted support). This means that the accounting of the Ministry of Culture has recognised

support that has not been received, and support that has not been granted. In other words, recognition of transaction has not been based on their economic substance.

48. The error in accounting is probably due to the fact that the legislation does not specifically regulate the manner of transfer to foundations of the remaining net assets of state agencies that have terminated their activities, the manner of its recognition in accounting and the manner of ensuring adherence to the State Assets Act upon transfer of assets. Thus it remains unclear who shall cover the outstanding debts once the state agency has been liquidated – the ministry or the foundation –, and who will be the owner of funds received from the recovery of claims of the state agency that has terminated its activities – whether said funds should be entered in the state budget or the account of the foundation. The National Audit Office recommended that the Ministry of Culture in cooperation with the Ministry of Finance specify and regulate the transfer of net assets to foundations established on the basis of state agencies, considering the economic substance of transactions.

49. Recommendations of the National Audit Office to the Minister of Finance:

- Identify the membership of agencies in the ministries' areas of government in non-profit associations and bring exercise of member rights in non-profit associations into conformity with the State Assets Act.
- Analyse the remaining assets of state agencies that have terminated their activities and the current practice of transfer of their assets and outstanding commitments, and regulate the transfer of net assets to (current assets and commitments) foundations established on the basis of state agencies.

Response of the Minister of Finance: we have contacted everyone exercising the rights of a member with a proposal to carry out further inspection of the participation of the ministry and its divisions in non-profit associations and, if necessary, inform the Ministry of Finance during the preparation of consolidated report.

We agree that it is necessary to analyse the current practice of transfer of assets and commitments of state agencies to foundations. Likewise, we find it necessary to specify in the General Rules of State Accountancy the accounting principles related to the transfer of assets and commitments of state agencies to foundations.

Rent expenses of the state have increased

Rent expenses of state agencies have increased after the transfer of their assets to Riigi Kinnisvara AS

50. In the 2012 consolidated annual accounts of the state the National Audit Office mentioned that the state has to keep in mind that transferring state assets to Riigi Kinnisvara AS (hereinafter RKAS) will cause a considerable increase in rent expenses. At the same time it is unclear where the funds required to cover the increase in rent prices will be found.

51. In 2013 the increase in rent expenses was inspected by the Ministry of Finance who commissioned a survey to compare the lease contracts

concluded with RKAS to market conditions. Pursuant to the state's property strategy a rent price will be agreed between the state agency and RKAS on the basis of market conditions, which is why the main objective of the survey was to provide an independent assessment of whether the rent prices agreed with RKAS are in compliance with market conditions. 343 contracts covering a total of 422,772 m² of lease area were inspected in the course of the survey.

52. The analysis of estimated contractual rent expenses revealed that in 2014 rent expenses will increase by 73%, i.e. 14.9 million euros, which will return to minimal (less than 2%) by 2015. According to the survey the main reason behind the increase in expenses in 2014 is that the two-year transitional period of most objects transferred to RKAS will end in 2014, and during the transitional period the rent of said objects was mostly 0 euros. Such sudden increase in rent expenses will not be seen in the next few years once the transitional period is over and the rent has been adjusted according to market prices.

53. The survey revealed that for most contracts it is not possible to directly compare the contractual rent and fee for non-core services to market conditions as there are no comparable objects in the market due to the nature, location or size of objects.

54. As a result of the survey the experts recommended abandoning market-based principle for the use of cost-oriented rent for most lease contracts. Thus, rent price should be determined on the basis of the object's expenses. This would ensure better comparability and influencing of rent and would significantly increase the transparency of rent.

55. In 2013 the National Audit Office also examined the expenses of objects transferred to RKAS and asked those ministries who are the largest lessees of RKAS to provide an overview of 2013 and 2014 rent expenses by individual lease contracts. In the audited ministries it became clear that the rent expenses of the Ministry of Social Affairs increased in 2014 by 0.7 million euros, i.e. 72%, those of the Ministry of the Interior by 7 million euros, i.e. 38%, and the Ministry of Culture by 2.7 million euros (proportional increase cannot be given as the transfer to a new rent price took place at different times for different objects). Table 1 gives examples of the biggest changes in rent price.

Table 1. Objects with the largest increase in rent (in euros)

Address of object	Town	User	Expenditure on the rent of object in 2013, and direct and indirect expenditure related to administration	Expenditure in 2014	Change (%)
J. Vilmsi 55	Tallinn	Folk Culture Center	24,191.16	95,334.22	394
Suur-Sõjamäe 44a	Tallinn	Repository Library of Estonia	40,854.96	363,693.67	890
Lai 1/ Nunne 4	Tallinn	Nuku Foundation	102,703.20	598,933.50	583

Rüütli 15	Tartu	Estonian Sports Museum	30,264.84	239,771.50	792
Astangu tn 27	Tallinn	Astangu Vocational Rehabilitation Centre	115,523.04	243,130.72	210
Gonsiori 29, 29a / Kollane 2	Tallinn	Ministry of Social Affairs	262,372.00	856,362.25	326
Põllu 23	Paide	Paide Rescue Command	19,986.99	91,052.30	456
Lai 7	Kohtla-Järve	Kohtla-Järve Rescue Command	42,071.89	149,827.60	356

Source: National Audit Office based on data provided by ministries

56. Most of the examples given in Table 1 are so-called special-purpose registered immovables for which RKAS has determined a market price but the experts who compared lease contracts to market conditions found that determination of market price is difficult as there is no reference base of similar objects in the market.

57. The National Audit Office agrees with the proposal of experts to review the rent model used by RKAS. The National Audit Office intends to carry out a more detailed inspection of the economic activities of RKAS in the course of a separate audit

58. In the previous year the National Audit Office recommended for the Ministry of Finance to explain in the Explanatory Memorandum of the 2014 State Budget and in the State Budget Strategy the length of time over which the increase in rent expenses will be financed in the state budget and the activities of Riigi Kinnisvara AS in agreeing on rent terms with the state will be managed. The 2014 State Budget Strategy does not include explanations on financing the increase in rent expenses or on plans for the management of the rent activities of RKAS.

59. Recommendation made by the National Audit Office to the Minister of Finance: consider the proposals of experts who compared lease contracts to market conditions and find an optimal rent model for rent spaces for which market comparison cannot be implemented.

Response of the Minister of Finance: we agree that the use of market-based rent is not justified and possible for all objects.

By now the rules for cost-oriented price formation for rent have been established and approved by the Regulation "General contractual terms for leasing improved property to the state and bases for rent price formation" of 30 September 2014 of the Government of the Republic.

However, we would like to point out that cost-oriented and market-based rent differ only in terms of capital expenditure. For the administrator of state assets, the established cost-oriented regulation is more favourable than the market-based approach upon transfer to RKAS as the value of transferred building is not taken into consideration. If RKAS were to invest in the assets (and investments are generally the purpose of transfer), the cost-oriented capital component is not significantly more favourable than market-based rent.

The main reason for the increase in service price is the previous poor funding of repair work and the fact that activities (administration,

maintenance, upkeep) that until now have been carried out with own workforce and covered from personnel expenses are commissioned as services. The latter apparently increases expenditure but actually just makes them visible in another expenditure entry.

The majority of state agencies have observed the requirements of the Public Procurement Act

Organisation of public procurements in state agencies

Pursuant to the Public Procurement Act effective in 2013, a public procurement had to be organised if the expected cost of the procurement contract without VAT was as follows:

- 40,000 euros or more in the case of a procurement contract for objects and services, and design contests; and,
- 250,000 euros or more in the case of construction works or public works concession.

Simplified procurement procedure

starts with the publication of a simplified procurement notice in the register, as stipulated in the Public Procurement Act effective in 2013.

The obligation to organise a simplified procurement generally starts from 10,000 euros in the case of contracts for things and services, and 30,000 euros in the case of procurement of construction works.

60. As state agencies spend a lot of money, the National Audit Office audited whether the Public Procurement Act had been adhered to in all ministries, Government Office and constitutional institutions in respect of acquisitions made in 2013.

61. In its audits the National Audit Office focussed on the internal control system that concerns the public procurement procedure, and assessed whether the procurements in certain selected transactions complied with the Public Procurement Act and the internal work procedures of the agencies. The National Audit Office checked whether procurement procedures were organised for public procurements, including procurements exceeding the limit for simplified procurements, whether the correct type of procedure had been selected and whether the requirements of the internal audit system and the Public Procurement Act had been observed in respect of the audited procurement procedures and simplified procurements.

62. In the audits of the previous year the National Audit Office identified shortcomings in procurement procedure and the preparation and updating of procurement plans. By this year the agencies have already improved their procurement procedures and procurement plans or are about to do it.

63. While in respect of audited acquisitions the agencies generally observed the Public Procurement Act, the National Audit Office still identified several breaches. Most of them were related to simplified procurements.

64. A significant breach is a situation where the agency has failed to organise a public procurement procedure, incl. simplified procurement, required by law. This was identified in the Government Office and the areas of government of the following ministries: Ministry of Education and Research, Ministry of Defence, Ministry of Culture, Ministry of Economic Affairs and Communications, Ministry of Agriculture, Ministry of the Interior and Ministry of Social Affairs. Procedures with negotiations were not organised either (both with and without prior publication), this was evident in the Ministry of Finance and Ministry of the Interior. In the Ministry of Education and Research and Ministry of Culture errors were identified in ordering services by simplified procedure.

According to the Public Procurement Act valid in 2013, a **public procurement report** had to be submitted to the Public Procurement Register in the case of purchases of things and services from 10,000 euros and orders for construction works from 30,000 euros (without VAT) within 20 days of entry into the procurement contract. **The annex to the public procurement report** had to be submitted after the procurement procedure had come to an end.

65. Public procurement reports and its annex were not submitted or they were submitted with delays. This was found in the area of government of the Ministry of Education and Research, Ministry of the Environment, Ministry of Finance and the Ministry of Defence, and in the Government Office.

66. While breaches of the Public Procurement Act have decreased, these breaches indicate the weaknesses in procurement planning, procedures and supervision system. The main shortcomings in the organisation of procurements are problems related to the different interpretation and implementation of the act and insufficient experience or capability. Detailed recommendations for the ministries in respect of the organisation of procurements can be found in the ministries' 2013 audit reports.

67. Recommendation made by the National Audit Office to the Minister of Finance: pay more attention to the organisation of simplified procurements in ministries and provide relevant supervision.

Response of the Minister of Finance:

Annual regular supervision of public procurements is based on a previous risk assessment. In the future risk assessments we will consider the National Audit Office's proposal to pay more attention to the organisation of simplified procurements in ministries.

When organising simplified procurements the suppliers can turn to us for advice and they can find additional information in the portal E-procurement Estonia. In the FAQ section there is a subsection "Obligations for below national threshold" that gives a more detailed overview of explanations and recommendations for organising simplified procurements.

In addition to counselling we organise public procurement trainings for suppliers both on own initiative and when commissioned by the supplier. One of the topics in the public procurement training programme is the regulation of organisation of simplified procurements. In the future we will consider the need to pay more attention to this procurement type.

Opinion on the accuracy of the Consolidated Annual Accounts of the State for 2013

The annual accounts of the state are accurate in all material respects.

68. The annual accounts of the state, which indicate that the state's consolidated result for 2013 was 284.6 million euros and its total consolidated assets amounted to 12.45 billion euros as at 31 December 2013, give a true and fair view of the state's financial status, performance result and cash flow for the financial year ended in all material respects and in accordance with the Generally Accepted Accounting Standards of Estonia.

Accuracy of annual accounts

Drawing attention to the state forest accounting policies

Did you know that

prior to changing the state forest accounting policies at the end of 2009, the book value biological assets, most of which was formed by state forest, was 1.8 billion euros.

Did you know that

as of 2010, only forest intended for cutting, which is found as an average sales estimate for ten years, i.e. only discounted income generated from the sale of timber to be cut in the future has been recognised in the balance sheet of the State Forest Management Centre. As the rest of the forest is not recognised in the balance sheet, it is not possible to make performances as to the state and value of the forest, for example, whether its value has decreased due to the timber remaining from a previous cut being less valuable, etc.

Qualification of certified auditors regarding Tallinna Sadam and refusal to express an opinion regarding Estonian Air

State forest is recognised without consideration of its nature

69. Unlike the Minister of the Environment and the Minister of the Finance, the National Audit Office remains in a different opinion when it comes to the accounting policies of state forest, and finds that said policies are not suitable for state assets.

70. The **book value of state forest** as a biological asset in the state's annual accounts as at 31 December 2013 is 776.5 million euros. According to current methodology, the book value of state forest has not been changed since the end of 2010 as the average sales price of timber has not changed by more than 10%. According to methodology, the book value is not changed in such cases and it is again recognised at the same value as in the previous period.

71. The National Audit Office feels that it must be considered that on the one hand, the quantity of managed state forest considerably exceeds the quantity of forest that is cut, but the accounting methods established with the General Rules of State Accountancy do not recognise this. On the other hand, the value of the state forest as a whole depends largely on the changes in the state forest, e.g. whether the forest left growing as a result of forest management has big or small reserves, whether they are coniferous or deciduous forests, etc.

72. On the basis of the 2010 and 2013 annual report of the State Forest Management Centre (hereinafter SFMC), which recognises forest land and forest reserves by main tree species, it can be observed that during the years in question both forest area in hectares and forest reserves in cubic metres has changed in terms of both managed and unmanaged forest, but that pursuant to the current accounting policies this change in forest value is not recognised as a change in the balance sheet total of the SFMC.

73. In conclusion the National Audit Office would like to draw the attention of the users of the consolidated annual accounts of the state to the fact that as long as the accounting policies of state forest remain the same, the consolidated annual accounts of the state will not provide accurate information on the changes in terms of the value of forest over the years.

The accounting of the foundations controlled by the state and the state's public undertakings is generally at a good level

74. The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency. The National Audit Office has not audited these agencies and its opinion is based on the opinions of the certified auditors who audited their annual accounts.

75. The opinions of the certified auditors of the 2013 annual accounts of public undertakings and foundations are unqualified except for the opinions provided for the annual accounts of AS Tallinna Sadam and AS Estonian Air. These qualifications did not affect the opinion of the National Audit Office of the accuracy of the consolidated report of the state.

Assets value test will identify the need for lowering the value of assets. The assets value test will identify the estimate sales price of assets or the useful value of assets (so-called covered value); if both are smaller than the book value of assets, the value of assets must be lowered.

76. As at 31 December 2013 the annual accounts of AS Tallinna Sadam recognise two berths related to the transport of goods and passengers, and their area as tangible fixed assets in a total of 45.2 million euros. The auditor is of a different opinion as to their value. The auditor of the company has commented that in the course of the audit it was not possible to carry out an **assets value test** to be certain about the assumption used by the management – increase in vessel traffic –, and thus the book value of fixed assets may not be accurate. The management of Tallinna Sadam checked the value of assets and did not consider it relevant to lower their value. As the same circumstances were present in the previous four financial years, the auditor also issued a qualified opinion in the previous years. According to the explanation of the Ministry of Economic Affairs and Communications the ministry is aware of the difference of opinion between the auditor and the management in terms of the value of assets, and the ministry feels that their perception of the assets' value is accurate.

77. The certified auditor refused to express an opinion on the annual accounts of AS Estonian Air because it was impossible to obtain sufficiently relevant evidence for determining whether the company's operations will continue. The annual report, however, has been prepared on the basis of a assumption that the company will continue operating. The auditor stated that the European Commission has initiated proceedings to inspect whether the loans given by the State of Estonia to Estonian Air in 2011–2013 constitute as unauthorised state aid. As a result of the inspection the Commission may require premature repayment of loans. The State of Estonia has submitted an application to the Commission to receive authorisation for providing state aid to Estonian Air, but the proceedings are underway and the result is unknown. The management of Estonian Air has admitted to not being capable of repaying loans prematurely and so the auditor found that it is uncertain whether Estonian Air will continue operating.

78. Certified auditors who audited the annual accounts of the state's public undertakings, foundations controlled by the state and profit-making state agencies have not been able to audit the regularity of transactions as there are no current standards of the Board of Auditors that would serve as a basis for auditing the regularity of transactions of the public sector.

Centralisation of support services proceeds according to plan

Accounting of state accounting entities and units

79. The project for combining all support services managed by the Ministry of Finance was launched in January 2010, its goal being to introduce the same financial and personnel accounting software and operating model in all state agencies and centralise support services by 2016. This project should improve the efficiency and quality of financial, personnel and wage accounting, ensure quicker access to financial and personnel information, transparency and wider consumption value, and decrease accounting expenditure.

80. As of 1 June 2014 most areas of government of the ministries, the Government Office, Supreme Court and the National Audit Office have implemented the SAP business software.

81. The National Audit Office has consistently audited the organisation of accounting in the ministries and the agencies in their areas of government. In the previous year the auditors found that centralisation of accounting has evened out the level of accounting in the areas of government of ministries and the organisation of accounting has improved in most ministries and their areas of government. A similar trend can be seen this year. For instance, the level of accounting has significantly improved in the schools belonging to the area of government of the Ministry of Education and Research, the accounting of which was centralised to the ministry in 2013.

82. The National Audit Office is of the opinion that organisation of accounting in ministries and their areas of government is generally at a good level. The number of shortcomings was bigger in the agencies of the Ministry of Education and Research and the accounting of the Ministry of Culture.

83. The internal control system of social benefits of the Ministry of Social Affairs is not efficient enough in accounting and needs improving. The accounting of social benefits will be carried out in the National Social Insurance Board's SKAIS database, which serves as a basis for entries into the VERP accounting program, which in turn serves as a basis for aggregate entries into the SAP accounting program. The entries are made manually, there is no automatic control, and data is not regularly compared in any other manner. In the course of an audit carried out in the Ministry of Social Affairs the National Audit Office identified differences between the data of SKAIS and accounting programs, which the ministry could not explain during the audit. This is why the National Audit Office carried out additional activities in the course of this audit.

Shortcomings in the cooperation between the Ministry of Social Affairs and the State Shared Service Centre

Operating model of financial and personnel accounting — description of work processes (incl. persons who complete them, deadlines and activities), which the accounting unit and the agency that is obliged to keep financial and personnel accounting have agreed on for the purpose of carrying out accounting.

84. State Shared Service Centre (hereinafter SSSC) was established at the end of 2011 with the objective of providing financial, personnel and wage services across the country. As of 1 June 2014 the accounting of the areas of government of the Ministry of Justice, Ministry of Social Affairs, Ministry of Finance and Ministry of Economic Affairs and Communications has been centralised in the Centre. Each ministry has entered into a cooperation contract with the Centre for the provision and use of the service, and the annexes of the contract include [the operating model of financial, personnel and wage accounting](#).

85. The centralisation of accounting in the SSSC has generally improved the ministry's accounting level. However, there are some problems with the provision of services. For instance, as of 2013 the SSSC has provided financial and personnel accounting services to the area of government of the Ministry of Social Affairs. There are still shortcomings in the cooperation between the ministry's area of government and the SSSC, which were pointed out by the National Audit Office already in the previous year. Problems with the source data of stocktaking and recording of results in accounting indicate poor exchange of information.

- Stocktaking does not serve its purpose – accounting of assets in the ministry is at a good level but there are still problems with the organisation of stocktaking of assets and obligations, and documenting in the State Shared Service Centre.

Pension appropriation – estimated obligation earned by the balance sheet date to be paid in the future.

- Accounting of **pension appropriations** for the employees of the Social Insurance Board is not reliable.

86. In response to the proposal made in the previous year regarding the centralisation of support services, the Ministry of Finance promised to carry out a customer satisfaction survey. The survey was carried out in 2013 and showed that the respondents are generally satisfied with the services, i.e. the aggregate rating of the quality of services was as expected (the aggregate rating was 7.4 points out of 10 and the expected level was 7 points).

87. In conclusion, the National Audit Office finds that the centralisation of state support services proceeds according to the agreed schedule, learning from mistakes and adjusting plans if necessary. As the centralisation is not complete it is not possible to assess whether the goals set by the Government of the Republic for the support services centralisation project will be achieved.

Reporting of state accounting entities can be made more efficient

88. According to the Accounting Act the ministries, Government Office and constitutional institutions are state accounting entities. They must keep accounts of their economic transactions and prepare an annual report. Deadlines for the preparation of the ministries' reports and the audit procedure will be established in the State Budget Act.

Annual reporting of ministries is only necessary for the preparation of the consolidated annual report of the state

89. Based on the reports of the ministries, Government Office, constitutional institutions, State Forest Management Centre submitted in the balance sheet records system the Ministry of Finance will prepare state's consolidated and unconsolidated annual report. For the preparation of the latter, the respective data of foundations and companies under the control of the state shall be added line-by-line to the unconsolidated data of the state. Basically, the annual accounts of the state can be seen as a report of a consolidation group and the ministries as consolidated units. Thus, the ministries' reporting must contribute to the objective of the preparation of the consolidated report of the state.

90. Once the consolidated report of the state has been audited and approved by the Government of the Republic it will be submitted to the Riigikogu for approval. According to the Accounting Act, the aim of the preparation of the consolidated report of the state is to allow the Riigikogu to control the government, provide the government with the opportunity to explain its activities in the accounting year, and present to the Riigikogu necessary information for making new budgeting decisions.

91. The Riigikogu will not approve the ministries' annual reports; it is responsible for the approval of the consolidated report of the state. Over the last decade the experience of the National Audit Office has shown that the approval of the ministries' annual reports is a formal procedure in the level of the Government of the Republic, and the substantial discussions of the execution of the ministries' budget and financial situation are not included in the sitting of the Government of the Republic. Nor are the annual reports used in the decision-making process by the ministries' managements. The reason behind this is that the aggregated report that is prepared six months after the end of the accounting year is not intended for management decisions. Apart from

the National Audit Office, there are no other significant national consumers of information interested in the ministries' annual reports. For example, for the preparation of the financial statistics of government sector Statistics Estonia uses more detailed data that is monthly submitted through the balance sheet records system.

Target – making reporting simpler for the ministries

92. In no way does this mean that the ministries and their areas of governments should not keep and maintain accurate accounts. Accurate accounts and financial information of state agencies is a necessary prerequisite for the preparation of quality financial statistics of the government sector. Indicators of financial statistics – unlike annual accounts – allow analysing and assessing the state's decisions related to the financial policy, comparing the state to other states and pointing out the change in the state's financial situation over time. Therefore, it is important that the ministries submit monthly balance sheet records, as it serves as an input for the preparation of the annual accounts of the state as well as financial statistics.

93. As the number of users of the annual accounts of the state accounting entities is small, the National Audit Office finds that reporting requirements should be reviewed and, if possible, made simpler. This would prevent the preparation of useless reports and would save the ministries' working time, currently spent on preparing bulky reports.

94. Updating of reporting must be based on the principle that it is necessary to ensure the adequacy of data for the consolidated annual report of the state and the financial statistics of the government sector, while trying to avoid gathering unnecessary data, preparing unnecessary reports and audits. The ministries, the Government Office and constitutional institutions must remain state accounting entities who submit monthly financial information to the balance sheet records system. The content and presentation requirements of annual reports should be significantly simplified. If possible, the requirements should be limited to a few main reports (e.g. balance sheet, income statement) and the preparation of a report describing the execution of the budget, as well as its approval by the management in the balance sheet records system. Here the aim should be to strengthen the links between the budget execution report and the management report. In terms of the consolidated report of the state, the requirements of the Accounting Act and the State Budget Act should be observed in full extent.

95. Recommendation made by the National Audit Office to the Minister of Finance: consider simplifying the requirements for state accounting entities to ensure sufficient data for the preparation of consolidated report of the state and financial statistics of the government sector, and make reporting of the results of financial year more efficient.

Response of the Minister of Finance: We agree with the suggestion to prepare proposals for amending the legislation so as to simplify the requirements for the content and format of the annual accounts of the state accounting entities. We will start working on this in the second half of this year.

Main observations in the financial audits of state accounting entities

96. Summaries of the audits performed in ministries are given below. The National Audit Office has given detailed explanations of the omissions found and recommendations on how to avoid them in the audit reports and memos sent to state accounting entities. The financial audit reports are available on the website of the National Audit Office. Relevant indicators of the ministries in 2013 are shown in Table 2.

Table 2. Relevant indicators of the areas of government of ministries in 2013

Ministry	Number of agencies in the ministry's area of government	Average number of employees	Budget size (million €)	Volume of assets (million €)
Ministry of Education and Research	77	5,238	528	430
Ministry of Justice	18	3,283	118	117
Ministry of Defence	6	4,270	346	456
Ministry of the Environment	6	1,398	284	1 478
Ministry of Culture	31	1,238	159	238
Ministry of Economic Affairs and Communications	8	1,309	618	2 911
Ministry of Agriculture	12	1,698	358	242
Ministry of Finance	5	2,399	4 433	4 270*
Ministry of the Interior	7	9,257	446	313
Ministry of Social Affairs	9	1,504	2 876	397
Ministry of Foreign Affairs	1	630	55	95

* Does not include the net assets of other state accounting entities.

Source: Balance sheet records system of the Ministry of Finance, accounting software SAP and State Treasury database

Ministry of Education and Research

97. The budget expenditure of the area of government of the Ministry of Education and Research in 2013 amounted to 528 million euros, which increased by 51 million euros compared to the previous year. The increase in expenditure in the area of government is mostly due to the increase in the financing of higher education, preparatory expenses for the organisation of general education school network, reformation of vocational programmes, and the increase in the number of research and development projects financed from foreign support. In 2013 the ministry made investments of 22 million euros, mostly in the renovation and furnishing of schoolhouses.

98. The annual accounts 2013 of the Ministry of Education and Research give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment

act and issued a note to Riigi Kinnisvara AS for making an unjustified prepayment of 2.2 million euros (also see art. 11–12). In other respects the funds had been used expediently.

99. Regardless of some small problems, the organisation of the acquisition and use of assets is at a good level and the preservation of assets is guaranteed.

100. When checking compliance with the Public Procurement Act, the National Audit Office identified two open public procurements that had not been organised. The Ministry has also failed to organise several simplified procurements, has submitted relevant documentation to the Public Procurement Register later than required, or failed to submit them.

Ministry of Justice

101. The budget expenditure of the area of government of the Ministry of Justice in 2013 was 118 million euros – an increase of 10 million euros compared to the previous year. In 2013 the ministry made investments of 4 million euros, mostly in the development of information systems and acquisition of IT equipment.

102. The annual accounts 2013 of the Ministry of Justice give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

103. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the ministry complied with the requirements of said acts. The funds allocated for investments and costs had been used expediently.

104. In terms of acquisitions the principles of the Public Procurement Act had been observed, organisation of the acquisition and use of assets is at a good level and the preservation of assets is guaranteed.

Ministry of Defence

105. The budget expenditure of the area of government of the Ministry of Defence in 2013 amounted to 346.3 million euros, which increased by 5 million euros compared to the previous year. The ministry made investments of 27.9 million euros, mostly in the renovation of barracks in Tapa and Jõhvi, and new contracts for the construction of barracks in Ämari, Jõhvi, Võru and Mine Harbour.

106. The annual accounts 2013 of the Ministry of Defence give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

107. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the ministry complied with the requirements of said acts. The funds allocated for investments and costs had been used expediently but the Defence Forces have made unjustified prepayments. The National Audit Office is of the opinion that internal procedures should regulate the making of prepayments by the Defence Forces so as to avoid prepayments upon purchasing goods and services that are procured under general conditions.

Economic procurement – procurement of the Ministry of Defence and Defence Forces for the acquisition of services and assets for a purpose other than defence.

108. The organisation of acquisition and use of assets for defence purposes in the ministry is satisfactory but shortcomings were identified in the organisation of **economic procurements** of the Ministry of Defence and the Defence Forces.

109. The Ministry of Defence and the Defence Forces have failed to organise simplified procurement procedures. The Defence Forces have purchased goods and services without a written contract or from companies who have not won the public procurement. The National Audit Office finds that it is necessary to supplement the internal control system for economic procurement, draw up a comprehensive economic procurement plan, and make supervision over the presentation of public procurement report more efficient.

Ministry of the Environment

110. The budget expenditure of the area of government of the Ministry of the Environment in 2013 was 284 million euros – an increase of 39 million euros compared to 2012. The increase in expenditure was mostly related to the increase in issued subsidies. In 2013 the ministry made investments of 5.7 million euros, mostly in the acquisition of land, software and supervision equipment.

111. The National Audit Office finds that in spite of the difficulties in the centralisation of accounting and introduction of SAP in 2013, the annual accounts of the ministry give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the ministry complied with the requirements of said acts. The funds allocated for investments and costs had been used expediently.

112. Although the National Audit Office did not issue a qualification regarding the ministry's annual accounts, the National Audit Office is still of a different opinion than the Ministry of the Environment and the Ministry of Finance when it comes to the recognition of the accounting policies of state forest and economic information of the State Forest Management Centre in the ministry's annual accounts. A more detailed description of the different opinion of the National Audit Office on this topic is given in articles 69–73 of this report.

113. The ministry and the agencies in its area of government have acted prudently and according to the applicable rules in acquiring, using and transferring assets. No significant errors were found by the National Audit Office.

114. The Public Procurement Act has been complied with upon the acquisition of assets and incurring expenses and no significant shortcomings were found by the National Audit Office. Some problems were identified in the organisation of procurements in the Information Technology Centre of the Ministry of the Environment.

Ministry of Culture

115. The budget expenditure of the area of government of the Ministry of Culture in 2013 amounted to 166 million euros, which decreased by 10.5 million euros compared to the previous year. The decrease was mostly caused by the establishment of foundations on the basis of public undertakings, which contributed to the decrease in revenue generated by

economic activities and the amount of received subsidies was smaller than in the previous year. In 2013 the ministry made investments of 6.9 million euros, mostly in the construction of the main building of the Estonian National Museum, and the renovation of Saaremaa Museum's Kuressaare Castle and the Estonian History Museum's Maarjamäe stables.

116. The National Audit Office issued a qualification on the recognition of fixed assets and financial investments related to the transfer of assets to the foundations. This aside, the annual accounts 2013 of the Ministry of Culture give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The ministry has complied with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act. Allocated funds have been used expediently.

117. Four problems were identified when assessing the transactions related to the establishment of foundations: transfer of assets by way of non-monetary contribution has been recognised in the wrong period, contributions in the foundation capital are of inaccurate value, expert revaluation of property has been ordered unnecessarily, and transfer of net assets has not been recognised accurately (see art. 46–49).

118. As at the balance sheet date, the Ministry of Culture has recognised among its fixed assets in its annual accounts certain assets of 5.4 million euros whose usufruct and right of ownership have been transferred to the foundation in the accounting year. A financial investment of the same amount, made in the foundation capital of the Eesti Kontsert Foundation, has not been recognised on the balance sheet.

119. The organisation of the acquisition and use of assets is generally at a good level and the preservation of assets is guaranteed. However, there are problems with the transfer of assets to the foundation.

120. The National Audit Office audited the ministry's acquisitions, including compliance with the Public Procurement Act in the ministry and audited agencies. In terms of audited acquisitions the principles of the Public Procurement Act have generally been observed but there are still cases where a simplified procurement has not been organised. In 2013, like in the previous year, no procurement was organised for purchasing air transport services for the ministry and food in the Estonian Maritime Museum. In 2013, the Estonian Open Air Museum also failed to organise procurements for purchasing food.

Ministry of Economic Affairs and Communications

121. The budget expenditure of the area of government of the Ministry of Economic Affairs and Communications in 2013 was 618 million euros – an increase of 30 million euros compared to the previous year. The increase is mostly related to the increase in the subsidies for public transport (25 million euros). The ministry made investments of 173 million euros, mostly in the construction and repairing of roads. In 2013 AS Eesti Energia and AS Levira were transferred to the area of government of the Ministry of Finance, which contributed to the decrease in the assets of the Ministry of Economic Affairs and Communications.

122. The annual accounts 2013 of the Ministry of Economic Affairs and Communications give a true and fair view of the ministry's financial

position, performance result and cash flow for the year ended in all material respects. As at 1 April 2013, the State Shared Service Centre has provided financial, personnel and wage accounting services to the area of government of the Ministry of Economic Affairs and Communications. The stability and continuity of accounting was ensured by the transfer of the relevant employees of the ministry to the centre. No accounting errors were found in the Ministry of Economic Affairs and Communications and its area of government.

123. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the ministry complied with the requirements of said acts in all material respects. However, like in the previous years the ministry has continued to conclude capital lease contracts with long-term obligations which the agencies in the area of government of the ministry had not included in financing transactions when preparing the budget.

124. In the scope of the audit the ministry has used the funds allocated for investments and costs expediently. Budget planning for the area of government has somewhat improved but in 2013, as before, the amount of revenue generated by economic activities at the account of which expenses could be incurred, was bigger than established in the Budget Act approved by the Riigikogu.

125. The ministry and the agencies in its area of government have acted prudently and according to the applicable rules in acquiring, using, transferring and writing off assets.

126. In the scope of the audit the ministry Economic Affairs and Communications and the agencies in its area of government have observed the principles of the Public Procurement Act, except for the Road Administration who failed to organise a simplified procurement required by the abovementioned act.

Ministry of Agriculture

127. The budget expenditure of the area of government of the Ministry of Agriculture in 2013 amounted to 358.4 million euros, which decreased by 11.8 million euros compared to the previous year. The decrease was mostly caused by the decrease in the supplementary direct aid to agricultural producers. In 2013 the ministry made investments of 2.6 million euros. Largest investments were made in the development of the software of an electronic fishing report system and the development of a new system for procedures and information management for the Estonian Agricultural Registers and Information Board.

128. The annual accounts 2013 of the Ministry of Agriculture give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the ministry complied with the requirements of said acts in all material respects. The funds allocated for investments and costs in the 2013 budget had generally been used expediently.

129. Regardless of problems in the organisation of public procurements and the sales activities of the Estonian Crop Research Institute, the

organisation of the acquisition, use and transfer of assets is generally at a good level.

130. While the National Audit Office did not identify any open public procurement that had not been organised in the agencies in the ministry's area of government, there were several shortcomings in observing the Public Procurement Act. Agencies failed to organise simplified procurements and observe other requirements of the Public Procurement Act. Most shortcomings were identified in the Estonian Crop Research Institute (formerly Jõgeva Plant Breeding Institute).

Ministry of Finance

Did you know that

In addition to the budget of the area of government, the Ministry of Finance in its Budget Execution report will also present the sums comprising the subsidies and other transactions of the Government of the Republic – equalisation and support funds allocated to the local authorities: 307 million euros in the budget and 305 million euros subject to execution.

The previous manner of presentation of the budget recognised transferable taxes as financing transactions, and distribution of received support and cash transfers to state agencies were not included in the budget and budget execution. The manner of presentation of the budget was changed in 2013: in the budget of the Ministry of Finance the proportion of distribution of received support (0.6 billion euros), transferable taxes (1.29 billion euros) and cash transfers to state agencies (1.93 billion euros) increased while the proportion of allocated subsidies decreased by 1.06 billion euros.

131. The budget expenditure of the area of government of the Ministry of Finance along with the budget of the Government of the Republic in 2013 amounted to 4.43 billion euros, which increased by 2.78 billion euros compared to the previous year. This increase is first and foremost related to the amendments made to the manner of presentation and principles of budget in the 2013 State Budget Act. In 2013 the ministry made investments of 8.5 million euros, mostly in the development of information systems, and the acquisition of software licences and IT equipment.

132. The annual accounts 2013 of the ministry give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

133. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the Ministry of Finance complied with the requirements of said acts in all material respects. The funds allocated for investments and costs had been used expediently. However, the agencies in the area of government of the ministry have entered into the kind of lease contract that created obligations that the agencies in the area of government did not consider financing transactions during preparation of the budget.

134. The Ministry of Finance and the agencies in its area of government have generally observed the Public Procurement Act. However, the Tax and Customs Board and the Information Technology Centre of the Ministry of Finance have not always organised procurement procedures required by the Public Procurement Act.

135. The budget expenditure of the area of government of the Ministry of the Interior in 2013 amounted to 432 million euros, which decreased by 41 million euros compared to the previous year due to a decrease in foreign support. The Ministry of the Interior made investments of 17.5 million euros, mostly in the acquisition of security and rescue equipment.

136. The annual accounts 2013 of the Ministry of the Interior give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

137. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the economic transactions of Ministry of the Interior complied with the requirements of said acts in all material

Ministry of the Interior

respects. The funds allocated for investments and costs in the 2013 budget had generally been used expediently.

138. There are problems with the stocktakes of fines receivable of the Police and Border Guard Board as some bailiffs have failed to forward to the Board information on fines receivable that are being processed. Regardless of this, the organisation of the acquisition, use and transfer of assets is at a good level.

139. When auditing the compliance with the requirements of the Public Procurement Act, the National Audit Office found that in comparison to previous years the procurement activities have improved but that there are still cases where simplified procurements have not been organised.

Ministry of Social Affairs

140. The budget expenditure of the area of government of the Ministry of Social Affairs in 2013 was 2.88 billion euros – an increase of 132 million euros compared to the year 2012. The budget increased mostly due to the increase in social benefits (pensions).

141. The National Audit Office issued a qualification regarding the accuracy of the recognition of 2013 social assistance and other benefits to natural persons, as the National Social Insurance Board failed to forward to the National Audit Office relevant source data necessary for auditing said expenditure in a timely manner, and did so much later. Thus it was not possible for the auditors to ascertain the accuracy and adequacy of received data. When auditing the consolidated report of the state the National Audit Office carried out the necessary audit activities that had not been performed before and did not identify errors. The National Audit Office found that the internal control system of the National Social Insurance Board is not sufficient enough to ensure the accurate recognition of social benefits in accounting (see art. 83).

142. Not considering the effect of the qualification included in the report, the annual accounts 2013 of the Ministry of Social Affairs give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

143. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the Ministry of Social Affairs complied with the requirements of said acts in all material respects. The funds allocated for investments and costs had been used expediently.

144. Asset accounting is at a good level in the ministry, but there are still omissions in the organisation and documentation of stocktakes of assets and liabilities.

145. With the exception of some shortcomings, the Public Procurement Act has generally been observed when purchasing goods and commissioning services.

Ministry of Foreign Affairs

146. The budget expenditure of the area of government of the Ministry of Foreign Affairs in 2013 amounted to 55.2 million euros, which decreased by 4.9 million euros compared to the previous year. In 2013 the ministry made investments of 4.9 million euros, mostly in the construction and renovation of embassies.

147. The annual accounts 2013 of the Ministry of Foreign Affairs give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects and in accordance with the Generally Accepted Accounting Standards of Estonia.

148. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and its amendment act and found that the economic transactions of Ministry of Foreign Affairs complied with the requirements of said acts in all material respects and the funds allocated for investments and costs had been used expediently.

149. The National Audit Office finds that the organisation of the acquisition, use and transfer of assets in the Ministry of Foreign Affairs is at a good level.

150. The National Audit Office audited the ministry's acquisitions and compliance with the Public Procurement Act. The audited acquisitions had been carried out in compliance with the Public Procurement Act and the auditors did not identify any shortcomings.

Constitutional institutions

151. In addition to the ministries the National Audit Office annually audits the Government Office and constitutional institutions: Office of the President of the Republic, Office of the Chancellor of Justice, Supreme Court and Chancellery of the Riigikogu. Constitutional institutions include the National Audit Office who will be audited by a certified auditor.

152. As a result of the audit of the Office of the President of the Republic, Office of the Chancellor of Justice, Supreme Court and Chancellery of the Riigikogu the National Audit Office finds that the annual accounts 2013 of these institutions give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

153. The National Audit Office issued a qualification to the Government Office regarding the sum of 80,000 euros given to the organisers of the events dedicated to the 95th anniversary of the Republic of Estonia, which was recognised as management expenditure of the Government Office but should have been recognised as subsidy, owing to its economic nature. Leaving aside the effect of the qualification, the National Audit Office found that the annual accounts 2013 of the Government Office give a true and fair view of the ministry's financial position, performance result and cash flow for the year ended in all material respects.

154. The National Audit Office also audited compliance with the requirements of the State Budget Act and the 2013 State Budget Act and found that the economic transactions of the constitutional institutions complied with the requirements of said acts in all material respects. The Government Office had erred in budgeting the expenditure for the abovementioned events dedicated to the 95th anniversary of the Republic of Estonia (see art. 14–15). The funds allocated for investments and costs had been used expediently.

155. The National Audit Office finds that the organisation of the acquisition, use and transfer of assets is at a good level. The audited acquisitions had been carried out in compliance with the Public Procurement Act and the auditors did not identify any shortcomings, except for the Government Office who failed to organise an open procurement and two simplified procurements.

/digitally signed/

Alar Karis
Auditor General

Recommendations made by National Audit Office and responses of the Minister of Finance

On the basis of the audit, the National Audit Office made several recommendations to the Ministry of Finance. The minister sent his response to the recommendations made by the National Audit Office on 4 August 2014.

General comments of the Minister of Finance on the audit report

The performances and proposals pointed out by the National Audit Office in the report give a good overview of the situation of the financial management of the state and of topics we must address.

Recommendations of the National Audit Office	Response of the Minister of Finance
Expenditure transferred to the next financial year 12. Proposal to the Minister of Finance: In order to ensure budget discipline and the transparency of budget planning, analyse the substance of the transfer of funds when preparing the budget execution report, and disclose it during the preparation of the Consolidated Annual Report of the State or the budget for the next period. (Art. 6–11)	Response of the Minister of Finance: When transferring state budget expenditure we have assessed the regularity and compiled a list of reasons why said funds were not used in the financial year. We will consider the recommendation to disclose the reasons. The State Budget Act authorises the Minister of Finance to establish the procedure for the transfer of state budget funds. We will update the procedure for the state budget strategy and state budget preparation. During the preparation of said regulations we will consider the opportunity to use the reasons for transfer more than before for preparing the decisions made during the preparation of the state budget strategy and state budget.
Long-term lease contracts 24. Proposal of the National Audit Office to the Minister of Finance: during budget planning regulate the treatment of rent transactions so as to comply with the State Budget Act and consider the principles of preparation of the financial statistics of the state. (Art. 16–23)	Response of the Minister of Finance: To increase the clarity of regulation we will replace the directive of the Minister of Finance that regulated the preparation of the budget up until now with a new respective regulation. To implement the new State Budget Act we are preparing a new regulation of the Minister of Finance "State budgeting strategy and procedure for preparing the budget project in the area of government of the ministry". The Draft regulation includes a provision which indicates that upon determining the nature of a capital lease and operating lease contract, guideline No. 9 of the Accounting Standards Board must be observed. To get an overview of lease contracts that cannot be terminated we will improve the requirements on data collection included in the regulations governing the preparation of the state budget so as to provide a better overview in the annual explanatory memorandum of the State Budget Act of current and future lease contracts that cannot be terminated. The overview will help control the entry into new lease contracts that cannot be terminated.
State participation in legal persons governed by private law 49. Proposal to the Minister of Finance: - Identify the membership of agencies in the ministries' areas of government in non-profit associations and bring exercise of member rights in non-profit associations into conformity with the State Assets Act. - Analyse the remaining assets of state agencies that have terminated their activities and the current practice of transfer of their assets and outstanding commitments, and regulate the transfer of net assets to (current assets and commitments) foundations established on the basis of state agencies. (Art. 37–48)	Response of the Minister of Finance: We have contacted everyone exercising the rights of a member with a proposal to carry out further inspection of the participation of the ministry and its divisions in non-profit associations and, if necessary, inform the Ministry of Finance during the preparation of consolidated report. We agree that it is necessary to analyse the current practice of transfer of assets and commitments of state agencies to foundations. Likewise, we find it necessary to specify in the General Rules of State Accountancy the accounting principles related to the transfer of assets and commitments of state agencies to foundations.
Rent expenses of the state 59. Proposal to the Minister of Finance: consider	Response of the Minister of Finance: We agree that the use of market-

Recommendations of the National Audit Office	Response of the Minister of Finance
the proposals of experts who compared lease contracts to market conditions and find an optimal rent model for rent spaces for which market comparison cannot be implemented. (Art. 50–58)	based rent is not justified and possible for all objects. By now the rules for cost-oriented price formation for rent have been established and approved by the Regulation “General contractual terms for leasing improved property to the state and bases for rent price formation” of 30 September 2014 of the the Government of the Republic. However, we would like to point out that cost-oriented and market-based rent differ only in terms of capital expenditure. For the administrator of state assets, the established cost-oriented regulation is more favourable than the market-based approach upon transfer to RKAS as the value of transferred building is not taken into consideration. If RKAS were to invest in the assets (and investments are generally the purpose of transfer), the cost-oriented capital component is not significantly more favourable than market-based rent. The main reason for the increase in service price is the previous poor funding of repair work and the fact that activities (administration, maintenance, upkeep) that until now have been carried out with own workforce and covered from personnel expenses are commissioned as services. The latter apparently increases expenditure but actually just makes them visible in another expenditure entry.
Compliance with the Public Procurement Act 67. Proposal to the Minister of Finance: pay more attention to the organisation of simplified procurements in ministries and provide relevant supervision. (Art. 60–66)	Response of the Minister of Finance: Annual regular supervision of public procurements is based on a previous risk assessment. In the future risk assessments we will consider the National Audit Office's proposal to pay more attention to the organisation of simplified procurements in ministries. When organising simplified procurements the suppliers can turn to us for advice and they can find additional information in the portal E-procurement Estonia. In the FAQ section there is a subsection “Obligations for below national threshold” that gives a more detailed overview of explanations and recommendations for organising simplified procurements. In addition to counselling we organise public procurement trainings for suppliers both on own initiative and when commissioned by the supplier. One of the topics in the public procurement training programme is the regulation of organisation of simplified procurements. In the future we will consider the need to pay more attention to this procurement type.
Reporting of state accounting entities 95. Proposal to the Minister of Finance: consider simplifying the requirements for state accounting entities to ensure sufficient data for the preparation of consolidated report of the state and financial statistics of the government sector, and make reporting of the results of financial year more efficient. (Art. 88–94)	Response of the Minister of Finance: We agree with the suggestion to prepare proposals for amending the legislation so as to simplify the requirements for the content and format of the annual accounts of the state accounting entities. We will start working on this in the second half of this year.

Overview of the Consolidated Annual Report of the State

The Consolidated Annual Report of the State has been prepared pursuant to the State Budget Act and the Generally Accepted Accounting Principles of Estonia. The Consolidated Annual Report of the State comprises the state's annual accounts with the State Budget Execution Report (i.e. the state's consolidated and unconsolidated report), additional information about local governments, the public sector and the government sector.

The accounts of 17 state accounting entities with the agencies in their areas of government, the State Forest Management Centre, 63 foundations under the control of the state and 30 companies are consolidated in the consolidated annual accounts of the state. Additional information is given about 226 local authorities, and the indicators of the foundations, non-profit organisations and subsidiaries under their control are also included. On top of the above, additional information about the government sector and public sector also contains legal entities in public law and entities under their direct or indirect control (see Figure 1).

The Minister of Finance is responsible for the preparation of the Consolidated Annual Report of the State and state accountancy is organised by the Financial Accounting Department of the State Shared Service Centre.

Figure 1. Entities consolidated in the Consolidated Annual Report of the State

Auditi iseloomustus

Reason and objective of audit

Pursuant to the State Budget Act, the National Audit Office must give its opinion on the accuracy of the Annual Accounts of the State and the regularity of transactions.

The objective of the audit is to express an opinion on the accuracy of the Consolidated Annual Accounts of the State for 2013 and the regularity of transactions. The Annual Accounts of the State contain the balance sheet of consolidated and unconsolidated assets and liabilities as at 31.12.2013, the consolidated and unconsolidated income statement, report on changes in net assets and cash flow statement for the financial year ended on 31.12.2013, a summary of the accounting policies and procedures used in preparing the annual accounts and other explanatory notes. The annual accounts contain the state Budget Execution Report as an additional report.

Principles of expressing an opinion

The opinion of the National Audit Office on the accuracy of the annual accounts of the state and the regularity of transactions means that

- the annual accounts are correct if they were prepared according to the Generally Accepted Accounting Principles and the Accounting Act, and disclose all of the significant information that gives a true and fair view of the state's financial status; and
- transactions are legal if performed in compliance with the State Budget Act, the 2012 State Budget Act and the 2012 State Budget Act Amendment Act.

As a note, the report draws attention to an error which, considering the amount and the circumstances related to the appearance thereof, is significant and will affect the opinion and performances of the reader of the annual report. 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 regarding the accuracy of the annual accounts and the regularity of transactions, but which could result in significant errors in the annual accounts or regularity of transactions under different conditions.

An observation is deemed significant if being aware of it has an impact on the user of the annual accounts. Significance depends on the content of the observation and its monetary amount, and it is evaluated against the background of the surrounding conditions. The monetary value of significance is found as a percentage of the assets calculated on the basis of the data given in the Consolidated Annual Accounts of the State.

The report does not include minor errors whose impact is not significant. The attention of the auditees was brought to the need to eliminate such errors in the course of the relevant audits and in the memos sent to them.

Scope of audit

In the course of giving an opinion on the accuracy of the state's 2013 annual accounts, the National Audit Office evaluated the compliance of the annual accounts with the Generally Accepted Accounting Principles of Estonia. The Generally Accepted Accounting Principles are based on internationally recognised accounting policies and procedures (EU directives on accountancy, international standards of financial accounting and international standards of state accountancy) and their main requirements are established in the Accounting Act of the Republic of Estonia, which are supplemented by the guidelines issued by the Accounting Standards Board as well as the General Rules of State Accountancy.

In order to express an opinion on the regularity of transactions, the National Audit Office audited whether or not the transactions of state agencies were performed in accordance with the State Budget Act, the 2013 State Budget Act and the 2013 State Budget Act Amendment Act in all material respects. For this purpose the National Audit Office focussed on the expediency and transparency of state budget implementation by checking the expedient use of the investments and expenses of state agencies, their adherence to the budget and the justification of prepayments and expenses.

In addition to expressing an opinion on adherence to the State Budget Act, the National Audit Office paid attention to adherence to the main principles of the Public Procurement Act and the State Assets Act when auditing regularity. For this purpose it checked, on a random basis, whether the procedure stipulated in the Public Procurement Act was followed in the case of acquisitions that exceeded the limit and whether the main principles of public procurements had been adhered to in respect of smaller acquisitions and evaluated whether assets had been used, preserved and transferred prudently.

Limitations of the scope

The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency. The annual accounts of companies, foundations and profit-making state agency were audited by certified auditors. The National Audit Office considered the opinions of certified auditors when expressing its opinion of the annual accounts of the state. The certified auditors who gave their opinions of the annual accounts of foundations, companies and profit-making state agency did not assess the regularity of their transactions and the National Audit Office has not performed any additional activities in this respect.

The National Audit Office does not give an opinion on the management report presented as part of the Consolidated Annual Report of the State. The figures presented in the management report, which arise directly from the annual accounts, were checked.

The National Audit Office did not carry out audit procedures to check additional information (annual accounts) about local authorities, the public sector or the government sector disclosed in the Consolidated Annual Report of the State.

Focus of audit

The National Audit Office performed the audit in accordance with the Audit Standards of the INSOSAI (International Organisation of Supreme Audit Institutions), which regulate auditing financial statements as well as the regularity of transactions within the scope of auditing financial statements. These standards require that an audit be planned and performed in a manner that allows the auditor to decide with sufficient assurance that the financial statements are free of any material misstatements and that transactions comply with the legislation specified in the description of the scope of the audit in all material respects. During the audit, evidence was collected about the figures presented and the information disclosed in the annual accounts as well as about the regularity of transactions. To plan relevant audit operations, the National Audit Office took into account the internal audit system introduced to prepare true and fair annual accounts and to observe the regularity of transactions without expressing an opinion on the efficiency of the internal audit. The relevance of the accounting principles and procedures used, the justification of the accounting assessments made by the management and the general manner of presentation of the annual accounts were also assessed in the course of the audit.

The National Audit Office is of the opinion that the audit provides a sufficient basis for expressing an opinion on the accuracy of the annual accounts and the regularity of transactions.

Time of completion of audit

The audit was completed in July 2014.

Audit team

Auditors of the Financial Audit Department took part in the audit, and it was managed by Gert Schultz, Senior Auditor of the Financial Audit Department in the capacity of Audit Manager.

Contact information

Further information on the audit is available from the Communication Service of the National Audit Office:

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An electronic copy of the audit report (pdf) is available online at <http://www.riigikontroll.ee/>.

A summary of the audit report is also available in English.

The number of the draft audit report in the internal records system of the National Audit Office is 2-1.8/14/60093/5.

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Earlier audits of the consolidated annual report of the state by the National Audit Office

15.8.2013 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2012**

27.8.2012 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2011**

15.8.2011 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2010**

31.8.2010 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2009**

28.8.2009 – **Report of the National Audit Office on the Consolidated Annual Report of the State for 2008**

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