

# **Annual report of the National Audit Office of Estonia**



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Name of authority: Riigikontroll

Registry code of authority: 74000056

Address: Narva mnt 11a, 15013 Tallinn

Telephone: 640 0700

Fax: 661 6012

E-mail: [info@riigikontroll.ee](mailto:info@riigikontroll.ee)

Chief executive: Mihkel Oviir

Auditor: AS PricewaterhouseCoopers

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**Dear reader!**

For the NAO, the year 2004 was the time to contemplate its activities and to learn as well as a time for innovations. It was also a year to remember everything we had been starting to forget about. What are we learning, then? Who we are, why we are and why do we operate on the account of taxpayers.

There is a board on the wall on the first floor of the NAO building displaying copies of old pre-war newspaper articles on the NAO. One of those articles is titled “Guardian of the state“. This sums up the essence of the NAO. The NAO has to be like a sailor on the lookout on top of a high mast, based on whose reliable information the helmsman can steer the ship and the captain adopt decisions. Our constitutional independence provides us with a panoramic view, it allows us to observe things in a wider perspective and from the distance, at the same time using the spyglass, if necessary, to get a more detailed look of one thing or other from the big picture and focus our attention.



The work of an auditor can be compared to that of many other professionals. One of those is definitely a doctor performing acupuncture.

In our work we have to be on top of things, and wise enough to know exactly where to insert the needle in order to stop the headache. It can be a leg, for example. Or in order to improve the work of the heart one has to stimulate a spot behind the ear.

Our opinion carries weight only if our audits are performed in a professional manner and our people know how the state really operates. Every inexperienced proposal or opinion decreases our reliability and narrows our opportunities to eliminate the problems in cooperation with the auditee. If we are thoroughly familiar with the auditee, people and policy, if we possess historical memory that allows us to know why one thing or another has been handled the way it has, we will have considerably better opportunities to see that the audited tax money would be used as wisely as possible. We cannot afford a situation where the ministry officials will smirk every time they hear of the visit of the NAO officials – here they come again with their naïve ideas.

Therefore, I adopted a decision in 2004 to change the NAO's current structure that was based on audit types to that based on ministries. In order to be able to provide the auditees with expert advice, the auditors themselves have to be familiar with the respective field – the new structure helps the auditors to delve into their area of activity. Only then can the NAO make expert proposals that can really be useful, so that we together can change our country for the better.

Our resources are limited as is everything in our small country. Thus we have to focus on what is important instead of paying attention to many things at the same time. Concentrating on small things prevents us from focusing on big questions that are primary in the life of the state and that require hundreds of millions or even billions kroons.

Generally we only look into the past when it helps to improve the process of making decisions regarding the future. Every audit must provide a possibility to draw conclusions regarding future behaviour. Then it has value and the money spent on this audit has been well spent.

I hope that this year we will be more able to rise above things, in the light of the decisions made in 2004, and look at them as a whole, observe the system, see the wood for the trees.

Mihkel Oviir  
Auditor General

# 1. Core activity of the National Audit Office

## Who does the National Audit Office work for?

The National Audit Office is an independent auditor that operates in the interests and on the account of taxpayers and has the task of looking into how the state and local governments have spent taxpayers' money and what they have offered in return. The results of the work of the NAO are first of all addressed to the Parliament, Government and the general public.

The NAO's relationships are maintained with the Government. While auditing a report, activity or key issue, we always treat it as "belonging" to someone, i.e. as a person's immediate obligation to take care and assume responsibility. Of course, the manager of the agency or entity being audited has the principal liability, but we have also emphasised the principle of the minister's liability for the area of government in question for several years. We deem it a natural and efficient way of solving problems by forwarding the majority of our suggestions to the topmost authority of an area of government who - even if not having a "personal relation" to the problem - bears the ultimate responsibility for what is going on in the area. At the disposal of a minister are the tools that enable systematic settlement of problems: a minister is able to not just finalise management-related nuances within an administrative agency, but refer problems to the Government in order to discuss them, to issue better orders and regulations that regulate the work of several agencies, and to initiate drafts of legislation.

While the National Audit Office and ministries act as discussion and debate partners, whose task is to see to it that the state manages the affairs of taxpayers as efficiently and economically as possible, the roles of the Parliament include both that of a designer of discussions and of an intermediary. On one hand, by issuing legislation the Parliament provides the framework discussions, on the other hand it evaluates, on the basis of the information submitted to it by the NAO, how in spending public money the Government has abided by the will of the people's representatives, i.e. laws. While doing that, the NAO is not only interested in the activity's official compliance with the legislation but also in whether the legislation and the activity of the Government is enough to ensure the expedient and purposeful use of the funds as well as reporting that would give an adequate overview of the expenses. Thus, the objective of communicating with the Parliament is to make proposals to improve the management of the state (i.e. first and foremost the use of taxpayers' money). It is not in the competence of the NAO to punish anyone, nor does it exercise authority, by making proposals the NAO helps those whose job it is to adopt decisions.

Being based on audits carried out during a year, the NAO prepares a summary report that will be presented to the Parliament - an overview on the use and preservation of state assets during the preceding fiscal year. This is the NAO's constitutional duty.

In this chain of relations, the role of the taxpayer is certainly that of the owner - without the taxpayer there would be no money to spend, the spending could not be audited and neither the spending nor the auditing could be evaluated. Since irrespective of the issue under review the case always concerns the money of the taxpayer, i.e. the owner, the results of audits carried out by the NAO are brought to the general public via the Internet and media.

Both the Constitution and the State Audit Office Act declare that the NAO is an independent institution that is competent to decide on the manner, time and nature of its audits. Nonetheless we do not aim at independence to an extent where nothing actually depends on us. We are ready to consider the wishes of those for whom we work within the scope of the criteria that we have established for ourselves (the aim of carrying out audits the results of which could be universalised in broader terms as regards the entire government sector; the number of people whom the topic essentially affects; the amount of money). Generally the audit objects are determined as a result of monitoring. This means that information has to be collected systematically regarding the areas of life that the NAO is interested in, in order to get an overview of the problems and the steps the state has taken to solve

them. In addition to looking for new audit objects we also observe the course of things when already audited objects are concerned, considering a follow-up audit.

In the international usage, institutions like the NAO are referred to as “supreme audit institutions”, which means that they have a say in other supervisory activities of the public sector besides the principal activity, i.e. audits. Auditors of the NAO advise officials in the development of management, accounting, control systems and audits. The single aim is to ensure that as much taxpayer money as possible is controlled with as few expenses as possible.

## **1.1. Financial Audit Department**

### **Essence of financial audit**

The State Budget Act establishes the obligation of the National Audit Office to give an assessment to the report on the implementation of the state budget, drawn up by the Government of the Republic. Preparation of the opinion on said report has been the duty of the Financial Audit Department and in order to fulfil that duty we planned and performed financial audits in a way that they would cover major cash flow, assets and liabilities that are important from the state’s point of view. That meant performing financial audits in both the ministries and their sub-offices as well as in foundations founded by the state, companies with state participation, etc.

Upon performing its audits the NAO relies on the auditing standards of INTOSAI (International Organisation of Supreme Audit Institutions) according to which the financial audit consists of

- the audit of the annual accounts including an opinion on financial reports;
- the legality audit observing the legality of transactions, i.e. assessing the compliance with applicable law and regulations (compliance with requirements).

While auditing the annual accounts we wish to assure its reader that the annual accounts correctly record the activities of the reporting entity during the period as well as its financial conditions at the end of the period. Upon auditing the legality of transactions we assess whether the auditee in its economic activities has complied with the relevant legislation applied in its area of activity.

Without giving an opinion we shall also point out the observations on financial management and internal control systems made in the course of the audit.

### **2004: a year full of changes**

In the NAO strategy we have set ourselves an objective to gradually expand the scope of the financial audit. In 2004, a significant change was carried out regarding the scope of the NAO’s financial audit. Before, the financial audits focused on auditing the annual accounts; in 2004, the NAO also gave an assessment on the legality of the auditees’ economic activities, which is in compliance with our long-term objective – to assure the Parliament and the public that money from the state budget has been spent pursuant to laws and other legislation as well as the will of the Parliament.

In the autumn of 2003, four audit teams, whose work would be based on the ministries’ areas of government, and one audit team focusing on county governments were formed in the Financial Audit Department. The year 2004 showed that the change in the organization of work had been justified. Focusing on a certain area makes the auditor’s proposals and suggested solutions more valuable for the auditees as we will be more able to consider the specifics of ministries and other authorities and that forms a base for the assessment of the legality of economic transactions and expediency. In addition, the auditors’ specialization on certain areas provided our auditees with definite partners for

cooperation (audit managers and auditors), who they can communicate with in the course of the audit and turn to for advice, if necessary.

We have continued to supplement the methodology of the NAO's financial audits in order to ensure the provision of a high-quality audit that would be in compliance with modern requirements as well as with international standards of auditing (ISA) and the auditing standards of the INTOSAI. Since the beginning of 2004, we have based the planning of audits and assessment of risks and evidence on the requirements of new international standards of auditing (which will also be integrated into the auditing standards of the). Relying on our practice as well as that of other supreme auditing institutions, we have developed the starting points and criteria for the assessment of the legality of transactions.

The NAO's financial auditors continued to work in cooperation with the Financial Control Department of the Ministry of Finance. As a result of this cooperation, a handbook of financial auditing for internal auditors was completed in December, 2004. We hope that the NAO's contribution, based on practical experience, to that handbook, i.e. its implementational part, will help the internal auditors in performing financial audits in the current year as well as in the future. We have also organized trainings for internal auditors, where we have described both the financial audit given in the handbook as well as our own experience in performing financial audits in a more detailed manner.

As of 2005, we can rely on the work of the internal auditors when auditing the annual report of the state. Preparations for that began already in 2004, when we started preliminary work on the change of the scope and organization of our financial audit, and submitted our methodic proposals regarding the performance of audits to internal auditors. Work schedules were also discussed and coordinated with the internal auditors and that creates prerequisites for a successful cooperation.

The NAO's audits and proposals made on their basis have contributed to the development of accounting in the public sector. In 2004, the general rules of state accountancy were implemented, and the employees of the NAO also contributed to its development. The implementation of the general rules was an important step towards the organization of the financial accounting of the public sector and it is with pleasure that we see that the annual accounts for 2004 are in compliance with the good practice of accounting.

## **2004 in numbers**

In 2004, the Financial Audit Department carried out a total of 28 audits. Audit reports were drawn up regarding each audit, and submitted to the Parliamentary Committee for State Budget Audit.

In addition to general financial audits, the Financial Audit Department also carried out three audits on economic activities. The latter differs from the classical financial audit by means of its scope, i.e. its objective is not to assess the annual accounts but it concentrates on the identification of shortcomings in financial management and internal auditing system as well as on making appropriate proposals, which give additional value to our work.

In 2004 we also audited the organization of accounting and legality of transactions of county governments (Ida-Viru, Viljandi and Pärnu County) and institutions under their authority.

In the summer of 2004, on the basis of performed audits, we prepared an overall assessment of the report on the implementation of the state budget, drawn up by the Government of the Republic. In that assessment we could state that the balance sheet total of the annual accounts audited by the NAO formed 82.6% if the state's consolidated balance sheet total as of 31.12.2003, the cash register expenses of audited authorities formed 23.7% of the cash register expenses of the 2003 state budget, and cash revenue of the audited authorities formed 91% of the revenue received in the state budget in 2003.

## **Significant audit results**

Compared to the previous period, the number of comments the NAO made regarding the annual accounts has decreased. An adverse opinion on annual accounts was also given only once, which is less than in previous years. In the opinion of the NAO, the decrease in comments is due to the fact that the ministries have implemented the NAO's proposals and the quality of reports has improved. So far, the good organization of accounting has not yet entirely spread from the ministries' central authorities to their sub-offices where there are more problems.

Regarding the legality of the auditees' economic transactions the NAO mainly had to point out harmful transactions regarding assets, and the failure to carry out public procurements. We hope that our comments and proposals will be put to use and that when auditing the legality of the transactions of 2004 we can see that the situation has improved.

Ines Metsalu

Auditing Manager of the Financial Audit Department,  
current Chief Auditor of Audit Department I



## **1.2. Operational Risks Audit Department**

### **Essence of the audit of operational risks**

The audit of operational risks includes the approach of both the financial and performance audit, starting with setting up the objective for a subsidy, activity licence or procurement, and ending with the assessment of a specific activity or the use of money. The objective is to help the state authorities to develop a wholesome control system that should prevent misspending, fraud and negligence.

Over the years the audited areas have stayed the same: subsidies allocated from the state budget, public procurements and activity licences. These areas are considered to be more susceptible to risk also by our colleagues from the supreme audit institutions of many other countries. Additionally, we have performed target audits in matters that require quick reaction.

#### **Fundamental issues of the audit of subsidies**

- Whether the regulation establishes inambiguously the objective, recipient and requirements of the subsidy?
- How will the applicant's right for the subsidy be investigated?
- What will be done if the recipient of the subsidy or the official has violated the conditions?
- Whether information on the conditions for the payment of the subsidy as well as on its recipients is accessible to the public?
- Whether the internal audit system enables to assess the legality and sufficiency of the activities of the payer of the subsidy even after the payment has been made?

#### **Fundamental issues of the audit of activity licences**

- Whether the regulation establishes the purposes and time for the implementation of the licence?
- Whether the requirements for the applicants are sufficient to meet the objectives of the licence's implementation?
- Whether the officials treat both the applicants and licencees equally?
- Whether monitoring has been guaranteed regarding the activities of the licencees and sanctions imposed, if necessary?
- What is the probability of operating without a licence and how the risk has been managed?

#### **Principles of auditing public procurements**

*Economy of the procurement* – the procured item (work, service) must meet the buyer's needs, the price of that being acquired has to comply with the market price or be less than the market price during the organization of the procurement, the buyer must receive that which he has acquired in a time suitable for him.

*Objective treatment of tenderers* – all tenderers must receive identical information regarding the wishes and activities of the buyer, the buyer cannot submit unnecessarily big demands to the tenderers.

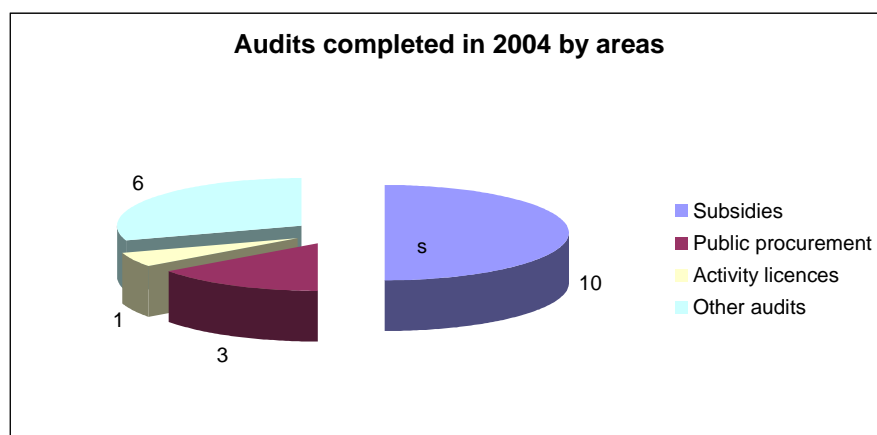
*Transparency of the procurement* – the buyer's activities and decisions must be clear to the tenderers and objectively reasoned.

*Controllability of the procurement* –the process of the procurement should be retrievable afterwards on the basis of the documents.

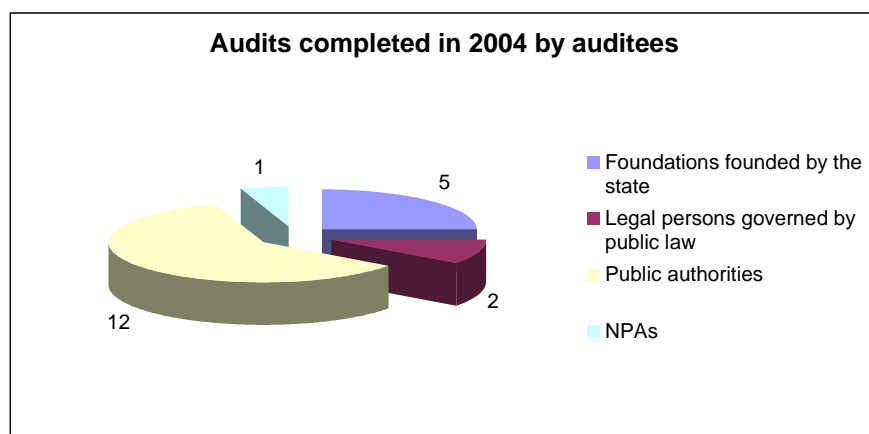
The objective of **target audits** is to give a quick expert assessment on the matter, and disclose that what has happened in order to prevent similar situations in the future.

## 2004 in numbers

In 2004, the department worked on 27 audits, 20 of them were completed, and one was carried out in cooperation with the Financial Control Department of the Ministry of Finance. Additionally, our auditors participated in several audits carried out by the Financial Audit Department.



In most cases the auditees were state authorities and, more than in previous years, also foundations founded by the state. We forwarded all audit reports to the State Budget Audit Committee of the Parliament; many audits have been already discussed by the Committee. In several cases we also informed the standing committees of the Parliament of the results of the completed audit.



## Significant audit results

Some examples of audits completed during the year are given below.

### Subsidies

Upon **auditing subsidies paid out of gambling tax** we stated that the Gambling Tax Council's priorities were general, requirements for applicants were not clearly defined, while reducing the amount of subsidy the project's aims were not taken into account, and reporting and supervision were not properly arranged. The Gambling Tax Council prepared and adopted new rules of procedure. The Ministers concurred with the submitted proposals regarding the evaluation of applications, organization of reporting and strengthening supervision.

## **Licences**

Upon auditing **weapons permits** we found that the risk that firearms are acquired by persons who might be dangerous to themselves or the others – due to their mental health, insufficient weapon handling skills or law disobedience – is not managed well enough. In his response, the Minister of Internal Affairs stated that the draft act for altering the Weapons Act was being prepared; in course of this work the proposals submitted by the NAO on how to supplement the Act would also be reviewed.

## **Public procurement**

We assessed the **procurement management in the field of IT systems, software products and software services** in the Ministry of the Environment, Ministry of Economic Affairs and Communications and Ministry of the Agriculture. None of the audited ministries had a long-term plan for information system development. In addition, no specific action plan had been drawn up for the preparation and implementation of any of the examined procurement projects. Furthermore, the Ministries had not adopted general rules for the acquisition of software and IT services. The NAO made a proposal to the Ministers to develop guidelines for the organization of procurements, the Ministers concurred with the proposal.

We audited the activities of the Ministry of Economic Affairs and Communications and Road Administration in the **organization of public procurement related to road repair**. We found that the state failed to comply with the Road Act when funding road maintenance activities, road projects included numerous mistakes, accountability issues related to planning had not been settled explicitly, competition situation in road construction sphere had worsened. The Minister and the Director General of the Administration concurred with the opinions of the NAO, the Minister informed the NAO of the measures to be taken to improve the situation.

## **Target audits**

When auditing the **management of privatization of public land**, the auditors paid attention to whether county governors had organised the privatization of land pursuant to the legislation and the objectives of the land reform. The audit identified mistakes arising both from the activities of organisers and shortcomings in the legislation. The audit pointed to the lack of effective supervision. In order to improve the supervision of land privatisation and to avoid the omissions and deliberate mistakes, the NAO recommended that the organisers of the privatisation should adopt provisions for the ex-ante verification and a posteriori supervision procedures, which would help to reveal and avoid errors and any nonconformity of information in the privatisation decisions and purchase agreements. In his response, the Minister of Environment noted that if the organisers of privatisation (county governors and local governments) had abided by the established rules there would be no reason to discuss the numerous abuses.

**The audit of the transfer of state land into municipal ownership** showed that entities organising the transfer of land interpreted differently the opportunity of applying for land under buildings and constructions retained in municipal ownership and the land for servicing them, as established by law. Some County Governors deemed it sufficient if the buildings and constructions were in municipal ownership at the moment of application for the land. Cases where land transferred into municipal ownership free of charge was later sold were frequent. The intended purpose of land that had been transferred into municipal ownership was often changed into commercial land or residential land,

whereas, had the intended purpose of the land been defined as commercial land or residential land in the first place, it would have been difficult to apply for the land from the state. Only one-tenth of the land that the state would presumably need had been finally formalised as the state land reserve. Local governments' lack of information concerning the state land reserve has increased the number of dismissed applications. The Minister of the Environment found that land belonging to a building in municipal ownership should not be transferred into municipal ownership in all cases, the need of local governments for land should first of all be determined in the detailed plans. The Minister considered necessary to establish the requirement to append extracts from the relevant plans and the justification of the application to each application.

\* \* \*

Operational Risks Audit Department was created in the NAO at the beginning of 2000. Due to the transition to a ministry-based structure the department ceased to exist on 30 November, 2004. During that period it carried out 110 audits.

A more thorough approach has improved both the administration of subsidies and various activity licences in the state – regulations on these subjects in the legislation are significantly clearer and the systems for checking the information used to adopt decisions better prepared, the activities of decision makers are as public as possible. Regarding public procurement it has become clear that the procurements have to be planned in advance, and that the authorities must have certain rules and procedures for the organization of procurements.

Although its structure does not include a separate department for operational risks audits any more, the NAO will continue to carry out such audits.

Jüri Kõrge  
Chief Auditor of Operational Risks Audit Department,  
current Chief Auditor of Audit Department III

### 1.3. Performance Audit Department

#### Essence of performance audit

The objective of the performance audit is to provide comprehensive information on the shortcomings of the activities of the public sector for the Parliament, Government and the public as well as to direct the responsible officials to eliminate said shortcomings. But the National Audit Office does not stop at identifying and characterizing the shortcomings, it also tries to analyze the reasons for the problems and suggest ideas for their elimination. Another objective of the performance audit is to identify the best administrative practice and contribute to their distribution.

The object of the performance audit and the monitoring activity the audit is based on include everyday problems and public sector's activity in solving them. The NAO tries to focus on problems that will influence a lot of people over a long period of time, and regarding which there is reason to suspect systematic errors in the state's activity. Avoiding getting caught in politics, the fact whether the Government has taken or planned to take any steps to solve the respective problem is also taken into account upon selecting objects for performance audit. Also, the audited problem may be one regarding which the Government does not have a specific plan of action but which is important for the achievement of a national objective specified on a more general level.

Performance audit focuses on three aspects – economy, efficiency and effectiveness.

**Economy** (minimizing the expenses made in order to achieve an objective) is generally not separately audited by the NAO but opinions on economy may be given when auditing efficiency.

Upon assessing **efficiency** the NAO analyzes the processes administered by the public sector – if and how it would be possible to increase the profit of the activities by using the same resources, or reach the same goal by spending less.

Upon assessing **effectiveness** the NAO analyzes the following:

- achievement of objectives declared in legislation and planning documents;
- actual effect achieved through the activity in comparison with desired effect (if there is no information regarding the effect or it is insufficient, the NAO itself will try to collect necessary information).

The NAO is also interested in the prerequisites of efficiency and effectiveness. This means that we analyze whether in planning and implementing activities the public sector takes guidance from the principle of sound administration and actual needs of society. Moreover, the NAO may also examine whether the Government has a purposeful plan of action to achieve certain social objectives, how it has developed, if and how it is connected to other activities of the Government and whether it is sufficiently managed. A lot of attention is paid to the existence and reliability of the reporting information characterizing expenditure, total net gain and effect.

#### Important developments

In 2004 the department focused on the question of how to increase the effectiveness of the performance audit. In cooperation with the expert of the supreme audit institution of the United Kingdom the NAO got acquainted with the experience of the British, and tried to find suitable ways to implement their best audit practice in Estonia. More attention has been paid to the selection of audit objects, planning of audits and the cooperation between the auditee and the auditor.

The structure, language and style of the report of the performance audit were harmonized in order to make the report easily readable and understandable for the reader. A template for writing the report of the performance audit was completed; an audit report written on the basis of this template will give the reader a quick overview of the audit and topics that might interest him.

“Implementation guidelines for performance audit”, guidelines written on the basis of the INTOSAI auditing standards and practical experience, were translated into Estonian on the initiative of the department. The guidelines address a wide number of topics and it serves as a basis for the performance auditor’s everyday work; the guidelines also introduce the framework of performance audits, address the general principles of auditing and describe various phases from planning to reporting the results.

## **2004 in numbers**

In 2004 the department carried out 18 performance audits, 13 of them were completed, including a special report. The rest of the six audits were completed in 2005. The department spent 62% of its working time on audit planning and auditing. The rest of the time was spent on other main activities and support processes, incl. trainings, development projects, etc.

## **Significant audit results**

An audit report left on the shelf is the worst thing that can happen to an audit. A good audit has to create positive changes in the state and provide the residents with a feeling of security regarding the use of taxpayers’ money. In other words, the completion of an audit report is half the victory. We can only be completely satisfied when there have occurred changes in the state as the result of the audit, and the result of those changes can be seen in a more sensible use of taxpayers’ money, improved quality of the state service provided to the residents, environmental protection and other relevant areas.

In 2004 the audits of the Performance Audit Department focused on four topics. These were:

- business environment;
- environmental protection;
- health;
- coping.

One audit that does not fall into any of these categories was also carried out – “Result of the administration of state-owned buildings”. The aims of objects with performed audits and their positive influence are listed below.

### **Business environment**

The objective of business environment audits is to contribute to the cost-effectiveness of the state’s activity in business development. Three audits were carried out under this topic: “Effectiveness of business support in creating jobs in the regions”, “Results of PHARE projects aimed at economic development” and “Outcome of the product development projects supported by the Enterprise Estonia Foundation”.

In the audit “Outcome of the product development projects supported by the Enterprise Estonia Foundation” the NAO assessed the results of projects supported by the Enterprise Estonia Foundation (EEF) up to now and how the EEF activity conduces to the attainment of the programme’s objectives. The audit report pointed out many shortcomings. Successful sales of products developed under the project or entrance into export markets have not been realized. Additionally, the report pointed out shortcomings in the organization of the EEF activity regarding support for product development; for

example, no information was gathered regarding the further well-being of entrepreneurs who had received support, the evaluation and decision making processes were not transparent. As a direct and indirect result of the audit, three relevant changes have been made to the organization of the distribution of support, which help to ensure that the support will fulfil its objectives. A systematic gathering of information has been started in order to receive information on the supported projects, reasons shall be given for both negative and positive funding decisions. Focus will be on the proper functioning of the value chain that will take into account the needs of entrepreneurs in the different stages of the project.

## **Environmental protection**

The objective of environmental protection audits is to help to reduce the risks to health and environment caused by the hazardous waste created as a result of human activity. The department carried out four environmental audits: “Government activities in eliminating residual pollution”, “Government’s readiness to eliminate extensive environmental pollution on land resulting from an accident”, “Organization of ship waste management in ports” and “Management of sea pollution incidents and recovery of pollution”.

The audits “Organization of ship waste management in ports” and “Management of sea pollution incidents and recovery of pollution” were carried out in cooperation with the supreme audit institutions of other countries by the Baltic Sea. On the basis of the mutually agreed criteria the implementation of articles on the protection of marine environment of the Helsinki Convention was analysed. The audit identified that there are no common rules for the organization of ship waste reception, there is neither supervision or penalties, as it has not been clearly established which state authority’s responsibility it is. Regarding the management of cases of sea pollution and recovery of pollution the audit found that the Ministry of the Environment has not been able to ensure compliance with the Helsinki Convention in the protection of the marine environment. Different authorities do not cooperate and the domestic legislation governing the field is deficient and unclear. As a result of the audits, a plan of action for 2005–2007 for the better organization of the protection of the marine environment, which establishes among other things the areas of responsibility of different ministries in providing protection for the protection of the marine environment.

## **Health**

Health audits focused on the availability and use of health services. Two audits were carried out on this topic: “Availability of ophthalmologic services” and “Organization of primary emergency care”.

The audit on the availability of ophthalmologic services audited one of the longest waiting lists in specialized medical care, waiting lists of ophthalmologists. The audit identified that the waiting lists of ophthalmologists differ considerably by medical institutions, waiting list information, forwarded to the Estonian Health Insurance Fund by medical institutions are not always correct and there is no hope for the waiting lists to become shorter as there are not enough doctors and more than half of the doctors have at least a part-time employment contract with optics stores. The NAO paid attention to the fact that at the moment the main opportunity to improve the availability of ophthalmologic services is to inform the patients of the current situation in a better way. As a result of the audit, the Estonian Health Insurance Fund has made the monitoring and inspection of waiting list information one of its priorities. According to the statistics, the waiting lists of ophthalmologists in hospitals that so far had the longest waiting lists (e.g. Tallinn Children’s Hospital and Tartu University Hospital) have shortened compared to the audited period.

The audit on the organization of primary emergency care audited the efficiency in the utilization of the existing resources for emergency medical service as well as whether the ambulance service performs the duties for which it has been called and how the emergency dispatch centres manage emergency

medical staff. The audit identified that the current system does not grant optimal access to emergency medical care and the operation of ambulance crews is too expensive; also, that one fourth of the calls do not require an emergency response. The more relevant influence of the audit is partially expressed in the principal viewpoint of the Ministry of Social Affairs during the preparation of the 2005 state budget, where one of the priorities of health is to improve the availability of emergency medical care, as well as its quality. Among others, its most important activities are altering the standards for the provision of emergency medical care service and coordinating the division of tasks among emergency medical care, family physician, nursing care and social welfare.

## **Coping**

Coping audits observe the provision of children's basic necessities and pre-school and basic education, availability of educational activities in spare time, as well as the existence of conditions necessary for a professional activity and for acquiring a profession. Three audits were carried out in this area: "Lack of teachers in schools of general education", "Functions and performance of special schools", "Planning of public investments for general education schools and the use of such funds", and a special report "Overview of problems with general education" was prepared.

The audit "Functions and performance of special schools" assessed the the referral of children to special schools, education work conducted in such schools and the later progress made by children having emerged from such schools. The report pointed out that referral to a special school is a time-consuming and cumbersome procedure, which leaves numerous children with behavioural problems without any supervision for a long time. It was identified that education and studies at special schools fail to consider the needs of a child and that systematic follow-up caretaking is lacking. As a result of the audit's proposals the state has started to pay more attention to the situation of special schools and has taken actual steps to improve it, incl. starting to reorganize the current special schools network and develop a plan of action to decrease the crime rate among minors.

## **Result of the administration of state-owned buildings**

The audit "Result of the administration of state-owned buildings" was carried out separately from the abovementioned topics. The audit formed a part of the overview of the use and preservation of state assets. The audit investigated to which extent and how does the state use its buildings and what is the condition of the buildings. The audit concluded that 37% of the buildings owned by the state are standing empty. Used buildings are generally composing and most most of the contracts of lease are damaging the state. As a result of the audit, all ministries promised to reduce the number of empty buildings and alter the damaging contracts of lease. In addition, the deadline for the preparation of the new draft State Assets Act was moved forward by a year, the new deadline being the end of 2005. As these are all changes whose actual results will take more than one year to be seen, we will maybe see the actual use of the changes in 1 to 3 years, as is the way with most performance audits.

\* \* \*

Positive changes were created not only by the proposals made as the results of audits, which generally all auditees concurred with, but also the discussions that accompanied the disclosure of reports in the Parliament, among the auditees, the public and other interest groups. In general, all audits were widely recorded in all relevant media. In the case of six audits, the Parliamentary Committee for State Budget Audit considered it necessary to invite the representatives of the NAO and the auditee to participate in the discussion of the shortcomings identified by the audit, as a result of which decisions were adopted on the future activities. It was not rare that the results and proposals of audits were addressed to the Government of the Republic, who in some cases formed an opinion on the subject.

Janno Veskimets  
Senior Auditor of the Performance Audit Department,  
current Senior Auditor of Audit Department II



#### 1.4. The NAO audit reports in 2004

*(Audits are listed by ministries and their areas of government. If one audit concerns the area of government of several ministries, it will be listed under every ministry in question.)*

##### Ministry of Education and Research

- Administration of payment of appropriations for school meals
- Planning of public investments for general education schools and the use of such funds

*(The NAO warns that tens of millions of kroons meant for investments for schools can go to waste because the Ministry of Education and Research has not established the criteria according to which it should be determined which schools will be able to survive in the future.)*

- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Education and Research as an individual authority in 2003
- National Audit Office's opinion on the legality of the annual report and transactions of Narva Vocational Training Centre in 2003
- Functions and performance of special schools

*(The NAO finds that special schools do not help children with behavioural problems to cope in life. Almost two thirds of students who have attended a special school have later committed an offence of some sort. Less than half the students in special schools have acquired basic education and probably only a few of the children can hope to find a paying job.)*

- Overview of problems with general education (special report)

*(Arising from the auditing principles of supreme audit institutions, in addition to the usual audit reports submitted to the Parliament, the NAO can also submit expert opinions and overviews based on auditing experience. The special report on the problems regarding the general education focuses on the NAO's educational audits of the past few years. The Parliamentary Cultural Affairs Committee has expressed interest in the overview of the general education.)*

- Economic activities of the Valga County Vocational Training Centre
- Lack of teachers in schools of general education

*(The NAO audited the lack of teachers in schools of general education, gathering information on the current teachers and analysing the preparation of state-commissioned education as well as the state's opportunities to alleviate the problem. As a result of the audit it can be said that almost three fourths of schools have had trouble finding teachers and the state has been idle when the organization of the teachers' labour market is concerned.)*

##### Ministry of Finance

- National Audit Office's opinion on the legality of the annual report and transactions of the Tartu County Court, Tartu Circuit Court and Tartu Administrative Court in the financial year 2003
- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Justice as an individual authority in 2003

- Economic activities of the Estonian Law Centre Foundation in 2003

## **Ministry of Defence**

- National Audit Office's opinion on the legality of the annual report and transactions of Single Signal Battalion in 2003
- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Defence as an individual authority in 2003
- Follow-up audit on the 2003 annual accounts of the Baltic Defence College

## **Ministry of the Environment**

- Management of sea pollution incidents and recovery of pollution

*(The NAO found that although the probability of an oil tanker accident with a massive impact in Estonian waters is quite big, the state is not capable of the timely detection of the pollution or to eliminate the pollution on its own, so endangering the entire Baltic Sea.)*

- Organization of ship waste management in ports

*(The NAO audited the organization of ship waste management in ports in the period of January, 2000 to June, 2004. The audit was carried out in cooperation with the supreme audit institutions of other countries by the Baltic Sea. It observed the state's activities in meeting the requirements of the Helsinki Convention in avoiding pollution from ships.)*

- Transfer of state land into municipal ownership
- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of the Environment as an individual authority in 2003
- National Audit Office's opinion on the legality of the annual report and transactions of the Estonian Meteorological and Hydrological Institute in 2003
- Government's readiness to eliminate extensive environmental pollution on land resulting from an accident

*(The NAO audited the organization of the state's activities if an environmental pollution should occur as a result of an accident on railway or highway. The audit shows three main shortcomings – the responsibility among different authorities has to be made clearer than before, there should be a system of mutual notification, and an environmental expert must be included in the elimination of the accident.)*

- Government activities in eliminating residual pollution

*(In its audit the NAO found that even though the elimination of residual pollution has been the Parliament's priority ever since 1997, the hazard of residual pollution on the environment and population has not decreased in the audited period due to lack of attention.)*

## **Ministry of Culture**

- Economic activities of the Estonian Film Foundation

- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Culture as an individual authority in 2003

## **Ministry of Economic Affairs and Communications**

- Use of government support for bus services
- Outcome of the product development projects supported by the Enterprise Estonia Foundation

*(The NAO audited the results of product development projects supported by the Enterprise Estonia Foundation in the period of 2001–2003 and found that up to now the business have not gained the economic influence – the products developed under the project have not been successfully sold neither in Estonia nor in export markets.)*

- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Economic Affairs and Communications as an individual authority in 2003
- Organization of public procurement related to road repair
- Results of PHARE projects aimed at economic development

*(The NAO analysed the assessment of the results and influence of PHARE projects aimed at economic development and the projects' sustainability. As the result of the audit it can be said that the aims of projects have remained unclear especially in the first years and the results are quite uneven. The assessment of the projects's sustainability and influence has not given a picture of the actual expediency of the use of the funds.)*

- Economic activities of AS Saarte Liinid
- The procurement management in the field of IT systems, software products and software services
- Effectiveness of business support in creating jobs in the regions

*(The aim of the NAO's audit was to analyse how state subsidies for businesses have contributed to the creation of new jobs in less developed regions. The audit concluded that while according to the national development plan the support of business is one of the main means of increasing employment, eight different development plans that address similar problems, target groups, aims and activities have still failed to clarify what is it that the state wishes to achieve by supporting businesses.)*

## **Ministry of Agriculture**

- Formation, replenishment and preservation of the national stockpile of grains
- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Agriculture as an individual authority in 2003
- National Audit Office's opinion on the legality of the annual report and transactions of the Veterinary and Food Board in 2003
- Audit of the financial year of the SAPARD
- Appropriation to the Estonian Chamber of Agriculture and Commerce

## **Ministry of Finance**

- Assessment of supervision over the organization of public procurements

- Result of the administration of state-owned buildings

*(The NAO found that approximately 37 per cent of the buildings owned by the state are standing empty and 80 per cent of the contracts of lease for buildings and rooms are damaging the interests of the state.)*

- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Finance as an individual authority in 2003
- National Audit Office's opinion on the annual report of the Tax Board and the report on the accrual of revenue in the state budget in 2003
- National Audit Office's opinion on the annual report of the Customs Board and the report on the accrual of revenue in the state budget in 2003
- Subsidies paid out of gambling tax
- Management of privatization of public land

## **State Chancellery**

- National Audit Office's opinion on the legality of the annual report and transactions of the State Chancellery in 2003

## **Ministry of Internal Affairs**

- Economic activities of the Estonian Migration Fund
- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Internal Affairs as an individual authority in 2003
- Weapons permits to natural and legal persons

## **Ministry of Social Affairs**

- Organization of primary emergency care

*(Upon auditing the work of the Estonian emergency medical staff that the current system does not ensure the optimal availability of the emergency medical care – on one hand, the emergency medical staff is overburdened with lightly made calls, on the other hand, during the time outside the working hours of their family physicians people do not have other means to get medical care than to turn to the emergency medical staff.)*

- National Audit Office's opinion on the legality of the annual report and transactions of the Ministry of Social Affairs as an individual authority in 2003
- Allocation to the Red Cross
- Formation, replenishment and preservation of the stockpile of medicinal products
- Economic activities of the Estonian Unemployment Insurance Fund
- Availability of ophthalmologic services

*(The NAO audited the timely availability of ophthalmologic services, i.e. the waiting lists of ophthalmologists, and the state's activities in ensuring the quality of the provision of ophthalmologic services. The aim of the audit was to assess the performance of the activities of the Ministry of Social Affairs, Estonian Health Insurance Fund and Health Care Board in guaranteeing the availability of health service.)*

- Tuberculosis control program for 1998 to 2003
- Economic activities of the Labour Market Board and its local authorities in 2003

## **Miscellaneous**

- Organization of accounting of Pärnu County Government and institutions under its authority in 2003
- Organization of accounting of Ida-Viru County Government and institutions under its authority in 2003
- Organization of accounting of Viljandi County Government and institutions under its authority in 2003
- Integration programme for 2000 to 2007
- Remuneration of management board members in public undertakings
- Allocation of funds from the state to a local government unit and control system implemented on the activities related to it (in an example of Kohtla-Järve City Government)

## 2. The National Audit Office as an organisation

### 2.1. Structural change

As of 1 December, 2004, the NAO renewed its structure in order to be competent and reliable even in a situation where the ever more complicated operating mechanism of the state and development of the society require the auditors to possess even more thorough knowledge in one area or another.

Up to that time the NAO's auditors were divided into departments by audit types, forming Financial Audit Department, Operational Risks Audit Department and Performance Audit Department. Now the abovementioned departments have been replaced by four departments that specialise on certain areas of government of the ministries and on their activities in carrying out the state policies.

In order to provide expert advice to the auditees, the people providing the advice have to be familiar with the respective field – the new structure helps the auditors to delve into their area of activity. Only then can the NAO make expert proposals that can really be useful, so that we together can change our country for the better.

There are now four departments in the NAO:

**Audit Department I** audits the area of government of the Ministry of Finance, Ministry of Foreign Affairs, State Chancellery and constitutional institutions. Chief Auditor is **Ines Metsalu**.

**Audit Department II** audits the area of government of the Ministry of Justice, Ministry of Defence and the Ministry of Internal Affairs as well as county governments. **Tõnis Saar** currently acts as Chief Auditor.

The duty of **Audit Department III** is to audit the area of government of the Ministry of Education and Research, Ministry of Culture and the Ministry of Social Affairs. Chief Auditor is **Jüri Kõrge**.

The auditors of **Audit Department IV** are responsible for auditing the area of government of the Ministry of the Environment, Ministry of Economic Affairs and Communications and the Ministry of Agriculture. Chief Auditor is **Olav Lüüs**.

Every new audit department performs two types of audits – financial audits and performance audits. Upon performing financial audits the departments' duty is to annually assess the validity of the claims the Government submits in financial reports, thus confirming whether correct accounting has been carried out regarding the funds and other assets of the public sector and whether they have been collected and spent pursuant to laws and other legislation regarding financial management. The performance of financial audit also helps to improve the efficiency of necessary control systems.

In the case of performance audits, the departments have to assess whether the funds of the public sector are being used in an economical, effective and efficient way in order to perform the state's duties, i.e. how to spend less while being expedient and creating as many new values as possible.

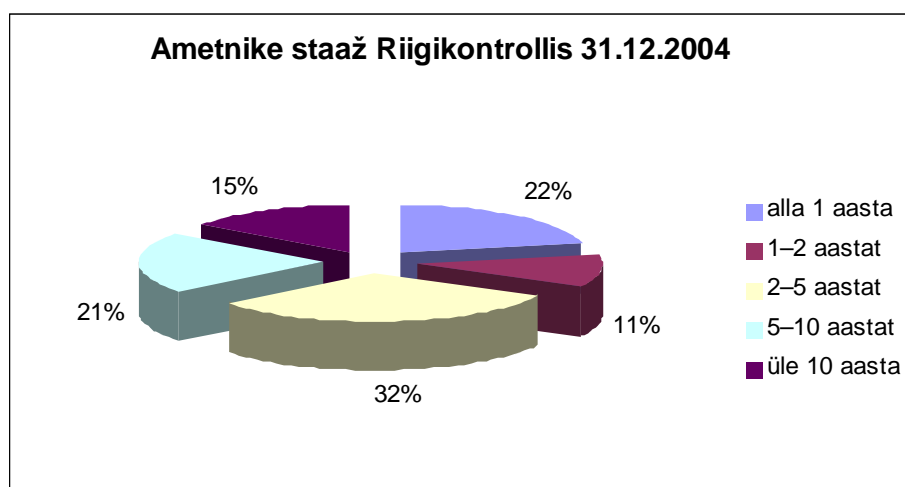
## 2.2. Personnel

At the end of 2004, the NAO employed 73 people. Compared to the beginning of the year, there are 10 people less, compared to the planned composition, as many as 20 people less.

On one hand, the year 2004 was sort of complicated for the employees of the NAO – some employees decided to leave their job, a structural reform was carried out, changes in management continued. On the other hand, the creation of new departments brought along new, educational challenges for the employees, reorganized management team was competent and possessed potential.

The highlights of human resources work during the year include the performance of surveys on organisation culture and satisfaction with work that provided useful information on management as well as development of the organisation of salary. Competition of academic studies was successfully carried out, new colleagues were found among the participants.

15% of the NAO's employees have worked here for more than ten years, and the share of those who have just assumed office (22%) and those who have worked 2–5 years (32%) is quite big.



Length of service of NAO employees as of 31.12.2004

Less than 1 year

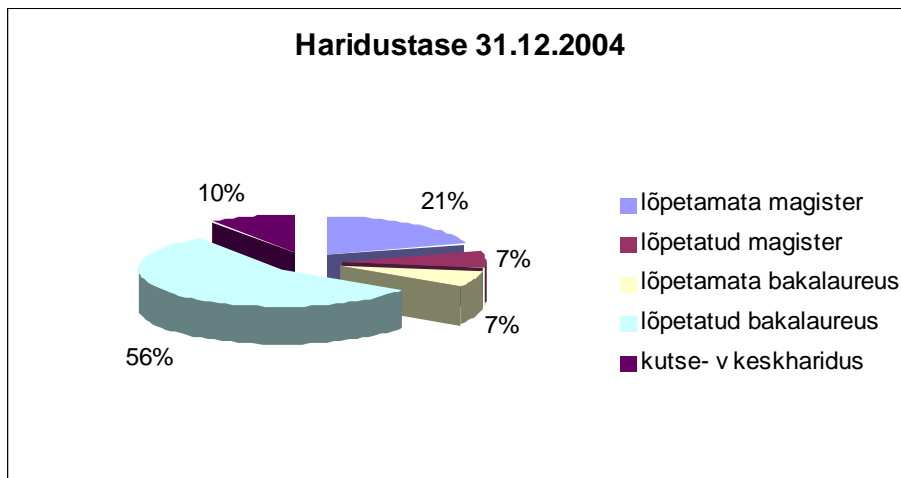
1-2 years

2-5 years

5-10 years

over 10 years

The vast majority of NAO employees have higher education – 84% of the employees. In the main branches of activity the proportion of higher education is even larger – only 10% of the employees do not have higher education and are not in the process of acquiring it. Quite a few employees are doing academic studies to obtain Master's degree – as much as 21 % of the staff will soon complete such studies.



Level of education as of 31.12.2004

unfinished Master's studies

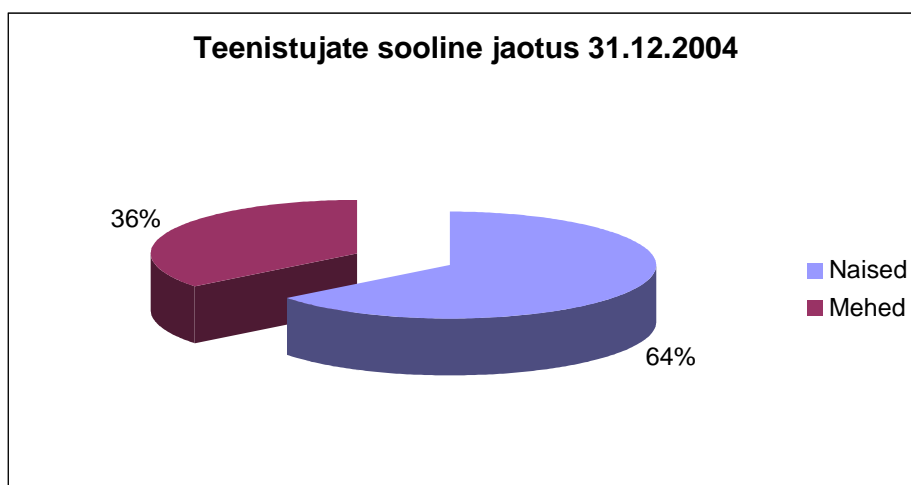
completed Master's studies

unfinished Bachelor's studies

completed Bachelor's studies

vocational or secondary education

The prevalence of women among employees, noticeable also in the previous years, increased somewhat.



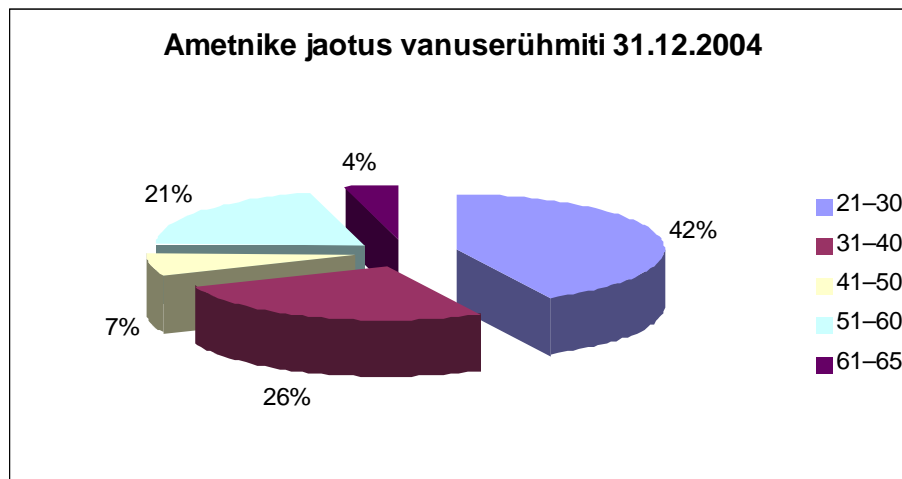
Distribution by gender of NAO employees as of 31.12.2004

Women

Men



The average age of staff is 37 years and the age group of those under 30 is the largest (42%), followed by the age group of 30 to 40 (26%).



Distribution of NAO officials by age groups as of 31.12.2004

Kairi Kübarsepp  
Head of Personnel Service

### **2.3. International relations**

Internationally, the year 2004 was a milestone for the NAO in several ways. Estonia's accession to the European Union on 1 May meant that the NAO had also achieved the objective, set many years ago – to shape itself so as to become an institution that would comply with the requirements of the European Union. And not only that – the NAO's expedient activities have played a significant part in improving auditing environment of the public sector, where the information and experience acquired in the course of foreign relations as well as the support of our foreign partners cannot be underestimated.

The end of the long-term integration process does not mean that we can now afford to be idle, as there are new challenges waiting for us. In addition to the prudential use of the European Union funds, the auditing of the sums transferred into the EU budget, including the auditing of the accounting and right of transfer of tax revenue, is also important. Considering this, the NAO participated in the value added tax working group of the European Court of Auditors and the supreme audit institutions of Member States.

The NAO was also represented in the working group that deals with the project "Financial management reports of the European Union" and has set as its objective that the supreme audit institution of each Member State would prepare an overview of the management, use, reporting and auditing of the European funds, so as to get an overview of the use of the European taxpayers' money and notify the Parliament and the public of it.

The accession expanded the opportunities for audit-related cooperation in the participation in the audits and working groups of Member States. As mentioned above, the NAO along with other EU states situated by the Baltic Sea audited the implementation of the Helsinki Convention, on the basis of common criteria agreed upon by the supreme audit institutions of this region. As the audit criteria arising from the international agreement are the same and the states have many common problems, it was reasonable to carry out the audit in cooperation with other countries. The audit results of the countries situated by the Baltic Sea were compiled into an aggregated report which gives the reader an opportunity to compare the organization of the protection of the marine environment in different states.

The cooperation between the European Court of Auditors and the supreme audit institutions of Member States is carried out through their heads' Liaisons Committees. The heads of audit institutions gather to a meeting once a year, where they discuss everything that has been done, and set objectives for liaison officials and working groups for next year. When the number of members has increased by ten, there are some things that have to be reassessed, and one of the main themes in the 2004 meeting of the heads of the 25 supreme audit institutions of the European Union and the Liaison Committee of the European Court of Auditors was the future organization of mutual communication and cooperation; the development of the proposals on this subject as well as that of the project will be the main task of the liaison officials and implementation team before the next meeting. The NAO will also make its proposals and form an opinion on the subject.

Another important milestone was the XVIII Congress of the INTOSAI (International Organisation of Supreme Audit Institutions), held in Hungary in the second week of October. The Congress approved the INTOSAI strategy for 2005–2010. Although the trends of the INTOSAI will essentially remain the same as before, the objectives and means for their achievement have been specified in a way that the INTOSAI could become the classic example of an organization operating economically, effectively and efficiently, which is also one of the strategic objectives. One of the main themes of the Congress was cooperation between supreme audit institutions that links well to the strategic objective to improve cooperation and common activities as well as sustainable development through the provision of knowledge, learning about the best practice, comparison of own results and research activities. So far the NAO has participated in the INTOSAI working groups of privatization and environmental auditing. Due to the objectives of the strategy, the forms of NAO participation in the work of the INTOSAI will need to be rearranged as well, the same applies to international relations in general.

In addition to abovementioned working groups, the NAO continued to participate in the work of the EUROSAI (European Organisation of Supreme Audit Institutions) Environmental Audit Working Group and IT Working Group as well as in the work of the working group of the auditing handbooks of the supreme audit institutions of the European Union. In addition to exchanging experiences and planning and carrying out specific activities, auditing methodology matters play an important role in the activity of working groups. The working group of auditing handbooks was especially formed to help the members to develop guidelines for auditing different areas and harmonise them with an intention to compile them in the auditing handbooks of audit institutions.

One of the four strategic objectives of the INTOSAI is increasing the professional performance and capability of audit institutions through training and other educational activities. NAO employees acquired knowledge and experience that cannot be acquired in Estonia in the seminars of the European Court of Auditors and the EUROSAI, in the two-week training course of financial and performance audit in the United Kingdom and acquiring experience in the European Court of Auditors, whereas the seminar organized by the EUROSAI Training Committee and IT working group described self-assessment in the area of IT, which is also something that the NAO is devising.

The NAO has been the initiator of the better organization of local government auditing, in order to ensure that the use of funds on every level of the public sector would be transparent and the auditing reliable. To this end, the NAO paid a visit to the National Audit Offices of Latvia and Lithuania in order to get acquainted with their respective experience. The connection between the supreme audit institutions of the Baltic States has been tight and past year, the tenth anniversary of the cooperation agreement was celebrated in Riga. This agreement gave birth to the annual meetings of the delegations of the supreme audit institutions of the Baltic States; the Nordic Countries joined the meeting in 2000, and Poland last year. The themes for the 2004 meeting were audits of tax and IT means. In addition to the exchange of information, such meetings allow for the making of useful contacts, and find experts and cooperation partners.

Mutual relations with other audit institutions play a very important role in the activities of the NAO. These relations enable the NAO to thoroughly examine the partners' organization of work and provides the base for cooperation agreements in specific areas and matters of mutual interest. The Auditor General and a delegation of the NAO made official visits to Finland and Denmark and a first-time visit to Bulgaria. Intense international cooperation with current partners shall continue in the future, and the NAO is ready to offer its knowledge and experience to the supreme audit institutions who are still surrounded by democratic reorganisations.

Rein Söörd  
Head of International Relations Service

### 3. Annual Accounts of the National Audit Office

#### **Management's declaration**

The Management declares its responsibility for drawing up the annual accounts of 2004 on pages 26 to 37 and confirms to the best of its knowledge that:

1. the accounting policies applied in the annual accounts are in conformity with the accounting principles generally accepted in Estonia;
2. the annual accounts reflect the financial situation of the accounting entity, the results of its operations and its cash flows in a true and fair manner.

Mihkel Oviir  
Auditor General

Tõnis Saar  
Director of the NAO

27.05.2005

## Balance sheet

(in kroons)

	Note	31.12.2004	31.12.2003
<b>Assets</b>			
Current assets			
Other claims and advance payments	3, 4	109 108	101 604
<b>Total of current assets</b>		<b>109 108</b>	<b>101 604</b>
Fixed assets			
Tangible fixed assets	5	23 401 574	22 291 728
Intangible fixed assets	6	110 641	156 762
<b>Total of fixed assets</b>		<b>23 512 215</b>	<b>22 448 490</b>
<b>Total of assets</b>		<b>23 621 323</b>	<b>22 550 094</b>
<b>Liabilities</b>			
Short-term liabilities			
Arrears to suppliers	9	146 555	80 730
Arrears to employees	9	721 886	823 205
Tax arrears and advance payments of taxes	3, 10	195 817	38 868
Loan commitments	7	0	95 333
<b>Total of short-term liabilities</b>		<b>1 064 258</b>	<b>1 038 136</b>
<b>Revenue accrued to the state budget</b>		<b>22 557 065</b>	<b>21 511 958</b>
<b>Total of liabilities</b>		<b>23 621 323</b>	<b>22 550 094</b>

Mihkel Oviir  
Auditor General

## Income statement

(in kroons)

	Note	01.01.2004–31.12.2004
<b>Operational revenue</b>		
Other revenue		50 048
<b>Total of operational revenue</b>		<b>50 048</b>
<b>Operational expenditure</b>		
Labour costs		
Remuneration costs	14	-17 592 272
Fringe benefits	14	-650 683
Taxes and social security contributions	14	-6 429 803
Total of labour costs		-24 672 758
Management expenses	11	-5 541 844
Tax, fee and fine expenses		-1 331 442
Depreciation of fixed assets	5, 6	-2 200 340
Grants awarded	13	-12 309
<b>Total of operational expenditure</b>		<b>-33 758 693</b>
<b>Operating result</b>		<b>-33 708 645</b>
<b>Financial revenue and expenditure</b>		
Interest expenditure	7	-3 042
Total of financial revenue and expenditure		-3 042
<b>Result of the period before the settlements with the state budget</b>		<b>-33 711 687</b>
<b>Net financing from the state budget</b>		<b>33 711 687</b>

Due to changes in accounting policies it is not possible to present the reference data of the financial year 2003.

# Report on the execution of the budget

(in kroons)

Classification	2004		2003	
	Budget	Execution	Budget	Execution
<b>Total of the revenue budget</b>	<b>0</b>	<b>50 048</b>	<b>0</b>	<b>0</b>
<b>38 Other revenue</b>	<b>0</b>	<b>50 048</b>	<b>0</b>	<b>0</b>
3888 Insurance indemnity	0	50 048	0	0
<b>Total of expenditure budget</b>	<b>34 007 672</b>	<b>33 998 742</b>	<b>32 004 000</b>	<b>31 890 638</b>
<b>4 Appropriation</b>	<b>14 000</b>	<b>12 309</b>	<b>16 000</b>	<b>13 310</b>
4500 Membership fees	14 000	12 309	16 000	13 310
<b>50 Personnel expenditure</b>	<b>23 833 600</b>	<b>23 833 600</b>	<b>21 477 522</b>	<b>21 477 521</b>
500 Remuneration	17 477 000	17 652 079	15 679 976	15 703 764
505 Fringe benefits	254 000	222 738	297 605	295 153
506 Taxes and social security contributions from the personnel expenditure	6 102 600	5 958 783	5 499 941	5 478 604
<b>55 Management expenses</b>	<b>6 200 000</b>	<b>6 199 964</b>	<b>7 290 478</b>	<b>7 286 446</b>
5500 Administration expenses	1 576 413	1 583 547	2 034 258	2 012 716
5502 Costs of commissioned research and development	86 783	86 783	100 000	51 646
5503 Mission expenses	903 000	923 057	766 000	754 418
5504 Training expenses	526 000	539 414	638 200	704 722
5511 Management costs of reg. immovables, buildings & rooms	1 765 900	1 722 339	2 253 900	2 239 401
5513 Vehicle maintenance expenses	332 300	333 509	260 000	297 336
5514 Information and communication techn. expenses	492 000	489 104	722 772	723 116
5515 Inventory costs	510 604	516 726	473 348	470 407
5522 Medical expenses	7 000	5 485	42 000	32 684
<b>65 Interest expenditure</b>	<b>4 000</b>	<b>3 590</b>	<b>21 000</b>	<b>20 845</b>
6502 Interest expenditure on financial lease	4 000	3 590	21 000	20 845
<b>Financing transactions</b>	<b>96 000</b>	<b>95 333</b>	<b>177 000</b>	<b>177 000</b>
2082 Financial lease payments	96 000	95 333	177 000	177 000
<b>15 Acquisition and renovation of tangible and intangible assets</b>	<b>3 860 072</b>	<b>3 853 946</b>	<b>3 022 000</b>	<b>2 915 516</b>
1551 Renovation of civil engineering works	3 181 289	3 176 494	2 000 000	1 962 311
1555 Acquisition and renovation of ICT-equipment	653 383	653 217	911 000	857 617
1557 Acquisition of non-depreciable values	10 000	8 835	6 000	5 988
156 Acquisition of intangible fixed assets	15 400	15 400	105 000	89 600

## Revenue

The NAO does not usually enter revenue in the budget. Other revenue in 2004 is entered as insurance indemnity in the value of 50 048 kroons received from the Claims Unit of IF Eesti Kindlustus for the elimination of a water leakage in the office building.

## Expenditure

Accrued expenses in 2004 were 33.8 mln kroons and cash-based expenses were 3.4 mln kroons.

The difference between the report on the execution of the NAO budget and the income statement is the result of the fact that the report on the execution of the budget is based on accrued expenses, whereas the income statement relies on cash-based expenses.

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Auditor General

## Cash-flow statement

(in kroons)

	Note	01.01.2004–31.12.2004
<b>Cash-flows from operating activities</b>		
Operating result		-33 708 646
Adjustments		
Depreciation of fixed assets	5, 6	2 200 340
Total of adjusted operating result		-31 508 306
Net change in current assets		-7 504
Net change in liabilities		121 455
<b>Total of cash-flows from operating activities</b>		<b>-31 394 355</b>
<b>Cash-flows from investing activities</b>		
Paid at the time of acquisition of the fixed assets	5,6	-3 264 065
<b>Total of cash-flows from investing activities</b>		<b>-3 264 065</b>
<b>Cash-flows from financing activities</b>		
Repayments of loans	7	-95 333
Paid interests	7	-3 042
Net financing from the budget	12	34 756 795
<b>Total of cash-flows from financing activities</b>		<b>34 658 420</b>
<b>Net cash-flow</b>		<b>0</b>
<b>Cash and its equivalents as at 31.12.2003</b>		<b>0</b>
<b>Changes in cash and its equivalents</b>		<b>0</b>
<b>Cash and its equivalents as at 31.12.2004</b>		<b>0</b>

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Auditor General



## Notes to the annual accounts

### Note 1

#### Methods of accounting and the bases of evaluation applied in the annual accounts

The annual accounts of the National Audit Office have been drawn up in conformity with the State Budget Act and the accounting principles generally accepted in Estonia. The generally accepted accounting principles are based on internationally acknowledged accounting policies (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 requirements set out in the general rules on state accountancy.

The annual accounts are drawn up by using the cost model. The cash-flows are drawn up by using indirect method. The annual accounts are presented in Estonian kroons.

Due to the difference in the accounting policies, the reference data on the income and cash-flows of 2003 is not presented and the reference data is partially absent also in the notes to the annual accounts.

#### Assets and liabilities

The assets and liabilities are divided as the short- and long-term ones on the balance sheet, depending on whether their expected period of use is up to, or more than one year of the balance sheet date. Holiday pay reserve is adjusted once a year – at the end of the financial year.

#### Tax claims and other claims

Tax claims and other claims are entered by using the adjusted cost model. The claims in the balance sheet are entered at the time the right of claim arises and they are evaluated on the basis of the amounts likely to be received. Where possible, the outstanding claims of each client will be assessed separately, taking account of the information known about the client's solvency. The claims unlikely to be received are assessed in the balance sheet at the amount they are likely to be received. The claims received in the accounting period but previously written off are entered as the reduced cost of the claims unlikely to be received in the accounting period. Claims are deemed to be hopeless if the management finds that it is impossible to collect them. Hopeless claims are written off from the balance sheet.

#### Tangible and intangible fixed assets

Tangible assets are the assets whose estimated useful life is more than one year and whose acquisition cost is at least 10,000 kroons. Assets with a useful life of more than one year and with an acquisition cost of less than 10,000 kroons, are entered as low-value inventory and written off at the time they are put into service.

Expenditure on reconstructions of fixed assets extending the useful life of the assets and improving their quality or increasing their performance when compared to the initial condition are capitalized on the balance sheet as fixed assets. Expenses on the repair and maintenance works to maintain the initial condition of assets are entered under the expenditure of the accounting period at the time they incur.

Fixed assets are entered at their acquisition cost from which the accumulated depreciation and the possible discounts resulting from the decrease in value are deducted. Two linear methods are used in the calculation of depreciation. Depreciation rate is determined separately for each object of the fixed asset, depending on its useful life.

Depreciation rates for fixed assets groups in a year are the following:

buildings and civil engineering works	2 %
machinery and equipment	20 %

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ICT equipment	33 %
other inventory, tools and fittings	20 %

Land and works of artistic value whose value does not decrease in time are not depreciated.

The assets without physical substance whose useful life is more than one year and whose acquisition cost is at least 10,000 kroons are entered as intangible fixed assets. Intangible fixed assets are entered at their acquisition cost, from which the accumulated depreciation and the possible discounts resulting from the decrease in value are deducted. Intangible fixed assets are depreciated in five years (20 % in a year) by using the linear method.

### **Financial and operational lease**

A rental contract in the case of which all important risks and benefits related to the ownership of the asset are transferred to the lessee is regarded as a financial lease. Other rental contracts are entered as operational leases. The payments of operational lease are entered as expenses evenly throughout the lease term.

An asset held under a financial lease is depreciated in the same way as acquired fixed assets, except in the cases where there is not enough certainty as to whether the lessee will acquire the ownership of the asset at the end of the lease term – in that case the asset is depreciated either during the lease period or the useful life, whichever is shorter. The financial lease payments are divided into capital repayments diminishing the payables and interest charges.

### **Accounting for taxes**

Not recoverable taxes and fees paid at the time of the acquisition of fixed assets or stock (e.g. value-added tax, if the buyer is not liable to value added tax) are entered as expenditure at the time of the acquisition and they are excluded from the acquisition cost of the assets.

### **Accounting for revenue**

Revenue is registered on an accrual basis.

### **Operations conducted in foreign currency**

Operations conducted in foreign currency are entered on the basis of the official exchange rate of the Bank of Estonia at date of the operation. Gains and losses from the foreign exchange operations are entered in the income statement as the profit and loss of the period.

### **Net financing from to state budget**

Acquisition of fixed assets and expenses is recovered from the state budget and entered as transfers received. The transfer of stated revenue to the state budget is entered as transfers made.

### **Events after the balance sheet date**

The annual accounts reflect some essential factors affecting the assessment of assets and liabilities. These factors emerged between the balance sheet date and the date of the annual accounts, but are related to the transactions concluded in the accounting period or previous periods.

The events after the balance sheet date which have not been taken into account when assessing the assets and liabilities, but which may essentially influence the result of the next accounting year, are declared in the notes to the annual accounts.

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**Note 2****Cash and its equivalents**

The treasury makes transfers from the NAO budget and administers all the receipts belonging to the NAO. With the consent of and subject to the conditions established by the Minister of Finance, the NAO had the right to use its non-group account in the Krediidipank to make non-budgetary transfers in 2004.

The turnover of the account in Krediidipank in 2004 was 452 762 kroons.

**Note 3****Transactions with public sector and associated bodies**

(in kroons)

**I. Liabilities and claims**

	<u>Short-term liabilities</u>		<u>Short-term claims</u>	
	<u>31.12.2004</u>	<u>31.12.2003</u>	<u>31.12.2004</u>	<u>31.12.2003</u>
Tax and Customs Board	195 817	38 868	0	3 508
National Archives	0	15	0	0
Centre for Public Service Training and Development	0	0	3 600	0
<b>Total of state accounting entities</b>	<b>195 817</b>	<b>38 883</b>	<b>3 600</b>	<b>3 508</b>
Eesti Post AS	6 341	4 026	0	0
Andmevara AS	0	192	0	0
EMT AS	13 623	9 217	0	0
Elion Ettevõtte AS	6 519	7 162	0	0
<b>Total of other transaction partners</b>	<b>26 484</b>	<b>20 596</b>	<b>0</b>	<b>0</b>

Liabilities to the Tax and Customs Board are specified in Note 10.

Liabilities to enterprises are entered under the balance sheet item "Arrears to suppliers".

Advance payments for training service in 2005 are entered under the balance sheet item "Other claims and advance payments"

**II. Expenditure**

	<u>Management expenses</u>	<u>Tax &amp; fee expenses</u>	<u>Total of expenses</u>
<b>State accounting entities</b>	<b>43 670</b>	<b>1 331 442</b>	<b>1 375 112</b>
Local governments	6 054	0	6 054
Other legal person in public law	51 141	0	51 141
Foundations and non-profit associations	5 400	0	5 400
Subsidiaries	36 280	0	36 280
Associated bodies	165 651	0	165 651
<b>Total of other transaction partners</b>	<b>264 526</b>	<b>0</b>	<b>264 526</b>

The majority of the tax expenses is calculated VAT – 1 325 093 kroons.

Land tax expenditure forms 6 245 kroons and interest expenditure 104 kroons.

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**Note 4****Other claims and advance payments**

(in kroons)

	<b>31.12.2004</b>	<b>31.12.2003</b>
Expenses of future periods paid in advance	104 472	87 845
Deductions from wages	4 636	0
Prepaid insurance premiums	0	10 251
Taxes paid in advance	0	3 508
<b>Total of other claims and advance payments</b>	<b>109 108</b>	<b>101 604</b>

The majority of the expenses of future periods paid in advance are the advance payments for periodicals in 2005 – 97 945 kroons (as at 31.12.2003, the advance payments for periodicals formed 79 875 kroons).

**Note 5****Tangible fixed assets**

(in kroons)

	<b>Buildings &amp; civil engineer- ing works</b>	<b>Machinery &amp; equipment</b>	<b>Other fixed assets</b>	<b>Unfinished works &amp; pre-payments</b>	<b>Total</b>
<b>Acquisition cost as at 31.12.2003</b>	24 166 817	5 561 575	3 373 726	1 918 798	35 020 916
Accum. depreciation as at 31.12.2003	-6 701 644	-3 632 301	-2 395 242	0	-12 729 187
<b>Residual value as at 31.12.2003</b>	<b>17 465 173</b>	<b>1 929 274</b>	<b>978 483</b>	<b>1 918 798</b>	<b>22 291 728</b>
<b>Changes in 2004</b>					
Acquisition and improvements	2 696 347	481 236	73 431		3 251 014
Reclassification	1 918 798	31 699	-31 699	-1 918 798	0
Depreciation	-483 336	-1 216 876	-440 956	0	-2 141 168
<b>Acquisition cost as at 31.12.2004</b>	<b>28 781 962</b>	<b>5 458 691</b>	<b>3 417 756</b>	<b>0</b>	<b>37 658 409</b>
Accum. depreciation as at 31.12.2004	-7 184 980	-4 233 358	-2 838 497	0	-14 256 835
<b>Residual value as at 31.12.2004</b>	<b>21 596 982</b>	<b>1 225 333</b>	<b>579 259</b>	<b>0</b>	<b>23 401 574</b>

The ventilation and cooling system in the value of 4 615 145 kroons was registered in the accounting period as fixed assets. The project began in 2003 and as at 31.12.2003, the cost of the works done was 1 918 798 kroons. The costs in 2004 were 2 696 347 kroons. The works continue in 2005 and the budget of 2005 foresees 1 050 000 kroons for the completion of the development of the ventilation

27 computers were purchased during the year in the total value of 339 445 kroons.

141 791 kroons was spent on the acquisition and improvement of servers and 73 431 kroons on replacing the inventory and furniture.

During the year, depreciated fixed assets in the acquisition value of 613 521 kroons were written off.

The assets were transferred to Puiatu Special School free of charge following the latter's request.

The composition of the assets transferred was the following: 17 laptops, 16 monitor, 4 PCs, 1 printer.

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**Note 6****Intangible fixed assets**

(in kroons)

	<b>Software</b>	<b>Total</b>
<b>Acquisition cost as at 31.12.2003</b>	<b>244 830</b>	<b>244 830</b>
Accumulated depreciation as at 31.12.2003	-88 068	-88 068
<b>Residual value as at 31.12.2003</b>	<b>156 762</b>	<b>156 762</b>
<b>Changes in 2004</b>		
Acquisition of assets	13 051	13 051
Depreciation	-59 172	-59 172
<b>Acquisition cost as at 31.12.2004</b>	<b>257 881</b>	<b>257 881</b>
Accumulated depreciation as at 31.12.2004	-147 240	-147 240
<b>Residual value as at 31.12.2004</b>	<b>110 641</b>	<b>110 641</b>

Intangible assets consist of software

**Note 7****Debt obligations**

(in kroons)

	<b>Obligation 31.12.2003</b>	<b>Repay- ments 2004</b>	<b>Interest expenditure 2004</b>	<b>Interest expenditure 2003</b>	<b>Interest rate</b>	<b>Obligation 31.12.2004</b>
Financial lease	95 333	95 333	3 042	20 845	3,19 %	0
<b>Total</b>	<b>95 333</b>	<b>95 333</b>	<b>3 042</b>	<b>20 845</b>	<b>?</b>	<b>0</b>

As at the beginning of 2004, the NAO had only one finance lease obligation with the repayment term ending on 30.06.2004.

The NAO leased office furniture from Hansa Liising Eesti AS under financial lease terms.

The contract was concluded on 30.06.2000 and the cost of the transaction was 1 265 134 kroons.

Purchased office furniture is entered as fixed assets under the balance sheet item "Other fixed assets".

**Note 8****Operational lease**

(in kroons)

	<b>Payments</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Paid operational lease payments	146 153	137 228	122 135

The NAO leases the following machinery and equipment under operational lease terms:

automobile Volvo (starting from 30.10.2001)

copier Minolta (starting from 07.11.2002)

The lease contract of the automobile will expire on 30.04.2005 and the contract of the copier on 30.11.2005.

The commercial lessor does not impose a fine on the NAO at the termination of the contract.

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**Note 9****Arrears to suppliers and employees**

(in kroons)

	<b>31.12.2004</b>	<b>31.12.2003</b>
Arrears to suppliers	146 555	80 730
Arrears to employees	721 886	823 205

Arrears to suppliers are unpaid invoices for the services provided in December.

Arrears to employees are entered as holiday pay liability due as at 31.12.2004.

**Note 10****Taxes**

(in kroons)

	<b>Tax arrears</b>		<b>Advance payments</b>	
	<b>31.12.2004</b>	<b>31.12.2003</b>	<b>31.12.2004</b>	<b>31.12.2003</b>
Social tax	185 101	38 341	0	0
Income tax of natural person	0	527	0	0
Income tax added to the fringe benefits	10 716	0	0	3 484
Contributions to funded pension	0	0	0	24
<b>Total</b>	<b>195 817</b>	<b>38 868</b>	<b>0</b>	<b>3 508</b>

**Note 11****Management expenses**

(in kroons)

	<b>01.01.2004-31.12.2004</b>
Administrative expenses on reg. immovables, buildings and rooms	1 531 833
Administration expenses	1 348 785
Mission expenses	870 682
Expenses on training tools and training	538 104
Information and communications technology expenses	488 585
Inventory management expenses	364 051
Vehicle maintenance expenses	314 031
Research and development expenses	73 850
Other expenses	11 923
<b>Total of management expenses</b>	<b>5 541 844</b>

Due to changes in accounting policies it is not possible to present the reference data of the financial year 2003.

**Note 12****Net financing from the state budget**

(in kroons)

Cash transfers from the state budget	<b>34 756 795</b>
Received from the state budget for making transfers	34 808 771
Receipts transferred to the state budget	-51 976
Transfers from the income statement	<b>33 711 687</b>
<b>Revenue accrued to the state budget as at 31.12.2003</b>	<b>21 511 958</b>
Net transfer for transferring the difference in the cash and accrual accounting results to the state budget	1 045 107
<b>Revenue accrued to the state budget as at 31.12.2004</b>	<b>22 557 065</b>

**Note 13**  
**Grants awarded**  
(in kroons)

	<b>31.12.2004</b>	<b>31.12.2003</b>
EUROSAI	7 323	7 345
INTOSAI	4 986	5 965
<b>Total of membership fees</b>	<b>12 309</b>	<b>13 310</b>

The NAO is the member of INTOSAI since 1992 and the member of the regional association EUROSAI since 1993.

**Note 14**  
**Labour costs**  
(in kroons)

<b>Remuneration costs</b>	<b>2 004</b>				<b>2 003</b>	
	<b>Graduated &amp; basic salary</b>	<b>Additional &amp; performance pay</b>	<b>Holiday pay</b>	<b>Grants &amp; benefits</b>	<b>Total of remuneration costs</b>	<b>Total of remuneration costs</b>
Officials						
Auditor General	427 698	85 539	73 047	37 114	623 398	441 694
Higher officials	4 054 625	1 012 920	622 353	1 024 459	6 714 357	5 971 140
Senior officials	5 738 627	1 229 618	866 304	1 476 453	9 311 002	8 905 674
Junior officials	555 787	36 604	30 982	27 524	650 897	198 965
<b>Total of officials</b>	<b>10 776 737</b>	<b>2 364 681</b>	<b>1 592 686</b>	<b>2 565 550</b>	<b>17 299 654</b>	<b>15 517 473</b>
Employees						
Workers and support staff	58 512	3 000	11 370	12 000	84 882	75 001
<b>Total of employees</b>	<b>58 512</b>	<b>3 000</b>	<b>11 370</b>	<b>12 000</b>	<b>84 882</b>	<b>75 001</b>
Temporary staff	207 736	0	0	0	207 736	111 364
<b>Total of remuneration costs</b>	<b>11 042 985</b>	<b>2 367 681</b>	<b>1 604 056</b>	<b>2 577 550</b>	<b>17 592 272</b>	<b>15 703 838</b>

<b>Average number of employees</b>	<b>2 004</b>	<b>2 003</b>
Officials		
Auditor General	1.00	0.76
Higher officials	24.76	19.,90
Senior officials	49.06	58.92
Junior officials	5.07	2.85
<b>Total of officials</b>	<b>79.89</b>	<b>82.43</b>
Employees		
Workers and support staff	1.00	1.00
<b>Total of employees</b>	<b>1.00</b>	<b>1.00</b>

<b>Fringe benefits</b>	<b>2 004</b>	<b>2 003</b>
Write-off of study loans	422 000	171 199
Other fringe benefits	228 683	295 844
<b>Total of fringe benefits</b>	<b>650 683</b>	<b>467 043</b>

<b>Taxes and social security contributions</b>	<b>2 004</b>	<b>2 003</b>
Social tax on wages	5 807 109	5 184 700
Unemployment insurance premiums	84 772	76 311
Income tax on fringe benefits	237 050	170 421
Social tax on fringe benefits	300 872	216 303
<b>Total of taxes and social security contributions</b>	<b>6 429 803</b>	<b>5 647 735</b>

Remuneration to the management forms 2 373 451 kroons from the remuneration costs.  
The management did not receive any additional fringe benefits.  
The management includes the Auditor General, Directors of Audit and the Director of Corporate Services.

#### 4. Auditor General's speeches and replies to inquiries from Members of Parliament

##### **On problems with use and preservation of state assets in 2003**

###### **Speech of Auditor General, Mihkel Oviir to the Parliament on 27 October 2004**

Honourable speaker, dear members of the Parliament,

A few days ago, on my way to work, I happened to hear on the radio an angry citizen railing against the Estonian government – saying that this is nobody's government but a gang of robbers and that money is spent on god knows what, and so on and so forth. Further, the citizen proudly announced that he had never elected to Toompea any of those freeloaders and he never will. That citizen's views clearly reveal how falsely people see the relation of the individual to the government and how they perceive their role. It is still somewhere in the back of our minds that this is somebody else's government and somebody else's money. And somebody else must take the responsibility but not us, the citizens. It is still not understood that there is no mystical government's money coming from god knows where and going to god knows where. This is our money, the taxpayers' money that we have entrusted to the Estonian government to be used as prudently as possible and for everyone's benefit. Thus the government is like a common cash box. And if the government manages this money prudently, we will all benefit. And when the money goes to waste, it goes from the pocket of each one of us. By electing the parliament every four years it is in fact the stewards of our money that we elect. And that angry citizen might at last realize that by ignoring elections he voluntarily surrenders the right to command his own money. And later there is no-one to accuse except himself.

Dear fellow taxpayers,

The function of the National Audit Office (NAO) as an independent auditor is to tell the parliament and the people whether the money that they have paid to our common cash box has been used lawfully, economically, efficiently and effectively, or in other words – whether the government has handled the money in a prudent manner. I believe that all Members of the Parliament have become thoroughly acquainted with the NAO report on the previous budgetary year, presented to the parliament two months ago. So today I will try to give certain clues to the honourable Parliament that might help dig into the causes of problems. May I also emphasize that one should be careful with interpreting and generalizing the examples presented in the report. The given examples are just selected isolated cases which have to be viewed in context and when torn out of context, they might make a false impression as if the activity of the Estonian government is but infringement.

This is not so.

Within a year the Estonian State has become better although it is a long way to perfection... At the same time, infringement has not become systematic and the NAO will take care that it never will.

Let us start with observations from last year.

My speech probably rings a bell for the senior Members of the Parliament – either in joy or in sorrow, because I am forced to revisit the issues that I already raised a year ago. Last year we failed to clear up the issue of government fees. We know the sum of fees actually paid, but we do not know how much should have been paid. It was nobody's business to check whether any fees were paid at all for the services provided. In this way the government may have lost tens of millions of kroons. Do we really have to await another incident with government fees like the one discovered by the NAO a year ago in the Estonian Motor Vehicle Registration Centre, in order to exercise supervision in the manner required by law? This year, however, many ministries have verified the receipt of government fees within their administration area as provided by law. However, last year it was not done by any



ministry and not even the Tax Board. Problems with public procurement are persisting – in the course of 25 financial audits we detected infringement of the Public Procurement Act by 19 agencies. This is far too much. It is no news that public property is leased for extremely low rents and thus no revenue is earned. In our estimation, about 80 % of leases have been made at a price which is at least 40 % more favourable than the market price. True enough, these contracts date mostly from the early 1990s and are valid according to the conditions of that time. It may be very difficult, indeed, to alter some of them, because a contract is a contract and amendments require the consent of both sides. But it is amazing how few contracts have been reviewed, although many contracts stipulate an annual update. What else concerns public property, as revealed by the NAO audit, an estimated 37 % of government-owned buildings stand without any use. Given the great number of football fans among the Members of the Parliament, may I say that the total empty space equals the size of 135 playing fields of the Lilleküla football stadium or 3,800 conference halls of the Parliament.

Part of those empty-standing buildings may already be destroyed and part may be falling into ruin. Probably there are many buildings among this property inherited after the withdrawal of Russian troops. But all this means that we do not have an overview of what our government has and what this is actually worth. It will become clear in one year's time when the re-valuation of assets acquired prior to 1995 must be completed. Today a building may be recorded in the accounts at the value of several hundred thousand kroons although in reality there are only walls left. At the same time there are occasions where an extremely valuable real property has been recorded at the value that is tens of times below the fair market value. What do you think is the value in the books of the famous House of the Brotherhood of Blackheads in Pikk Street in Tallinn? 97 thousand kroons...

One of the issues that the NAO has been revisiting from year to year is apartments held by the government. Since there is no comprehensive overview of government-owned apartments, the NAO had to prepare it on the basis of enquiries.

It was revealed that the government has about 2,400 apartments which have received over EEK 20 million in investments over the last five years ... The tenants of almost 400 apartments do not have current employment relationship with the respective ministry or county government. It is my true belief that the government must retain only these apartments that it really needs – for instance apartments meant, by law, for the officers of the Defence Army or the Border Guard. The rest of the apartments should be sold or transferred to the Public Limited Company "Government Real Estate". At this it is essential to clearly establish how the sale is to be performed. The NAO considers it to be necessary that by 2010 the government would only own the apartments, buildings and land that are necessary for government affairs... The Government has agreed to this suggestion.

Honourable Members of Parliament,

The wrong or irresponsible use of money is a consequence. But problems, which the NAO has referred to, take their rise from attitudes. There are officials who think that if they do not respect the law nothing will happen. And indeed, nothing happens in most cases, because the question as to whose responsibility is somebody's activity or inactivity simply remains without answer. But it is namely the question of responsibility that is central to the entire civil service – the responsibility must be made specific in respect of every work assignment. Unless this is done, the ministers, chancellors, ministerial officials and others regard a task as somebody else's business. This leads to inactivity and the work remains undone. Such a state of affairs was conducive to the theft of grain and gas mask filters from the national emergency stocks.

A few years ago there was incessant complaining about the lack of political responsibility. It was told that ministers are not aware of responsibility and do not leave office if our money is wasted within their administration area. Political responsibility was evaded by referring to the need to hear the opinions of the prosecutor and the court. Political responsibility was not perceived as a distinctive category of responsibility but just as a type of legal responsibility. To date we have achieved the recognition of political responsibility – Tiit Tammsaar resigned because of the grain theft, Signe Kivi resigned because of the affair in the Cultural Endowment. But the other side of responsibility is now

lost. Nothing is told about legal and administrative responsibility. In the grain theft affair, too, we can sense the wish to reduce responsibility only to criminal liability. It is but natural that the thief is liable to criminal prosecution. But from the administrative point of view, those that must take responsibility are the officials who were appointed by the government or by all of us to take care of the good management of this grain. The NAO found plentiful facts about the malfunctioning of the chain of responsibility. For example: The Council of the Estonian Granary did not verify whether the Board had ensured the preservation of the nation's stockpile of grain. The Council had failed to discuss a number of important issues, like the development of the methods for grain investment, reliability of stock-taking, or the selection of and the verification of the reliability of grain managers. The Ministry lacked even an overview of the contracts under which the Estonian Granary had delegated the management of grain. Neither had the reliability or economic status of grain depositors been checked. There were also reasons why the chain of responsibility could not function. Although the nation's emergency reserves are confidential, the Members of the Council of the Estonian Granary did not have right of access to government secret. And such a right had never been sought! Hence, those people had to know that they accepted the remuneration of the Council member solely for keeping a chair warm and nodding along with the Board. The members of the Parliament committee set to guard over the Estonian security agencies would be in the same absurd situation unless they had access to the government secret. They would then evaluate the work of the Security Police apparently according to what the papers print. By the way – setting aside the Council, the Board of the Estonian Granary did not have right of access to the government secret either, although they possessed complete information about the stored grain. And the new management and the new Council of the Estonian Granary assumed office after the scandal still have no right of access to the government secret. I earnestly do not know whether to laugh or cry.

Honourable Board, Members of the Parliament,

In global practice the responsibility of a company's Council is proved to be growing. As a representative of the owner, the Council is held responsible for strategic management, cost-effectiveness and management of all kind of risks. As the Auditor General I am convinced that the government must bring an action against the Members of the Council of the Estonian Granary and make a claim against them collectively for the millions that vanished from our pockets due to their negligence and non-professionalism.

To create a precedent, the matter must go all the way up to the Supreme Court. Then it would be clear whether the current law is deficient and needs amendment... or simply proper enforcement.

The case of the Council of the Estonian Granary refers more widely to the necessity of laying down who and how can represent the government in the Councils of companies in which the government has a share. This issue was dealt with by the Legal Chancellor who appeared before you only lately. I wish to address the issue from the point of view of money and risks.

When I talk to the chancellors of the ministries, in confidence, they say: "Yes, I can see inherent risks here, but there is nothing I can do. I would not have sent any of those persons to the Council, but the minister wanted so. This was a political decision". When I talk to the Board members about the Council, they snigger and say: "Come on, the people sitting on the Council are often those who are unable to make head or tail of this business."

I am inclined to believe that in order to tackle the problem of Councils and Council members, a body of expert councillors as a separate entity should be set up at the Ministry of Finance. The task of these people would be the representation of the government's interests in the Council of a company. And these should be people who really know the business.

In case of certain strategically important companies it may be necessary to have leading politician in the councils, but in that case they should be designated by the Parliament, their remuneration should

be determined by the Parliament and they should be accountable to the Parliament and not the minister.

Next let us set to problems concerning the state budget and its implementation.

Money is the main resource with the help of which the parliament is realizing the policies approved by the people. The debate on the next year's state budget is currently under way in the Parliament. The state budget is a law, I stress again, a law, according to which our money will be allocated next year. And it is your task to ensure, by approving the state budget, that this money is allocated in such a way that each cent is spent purposefully. The good causes on which the Government intends to spend the requested money are not spelled out in the draft Budget Act but in the explanatory memorandum attached to it ... in that 500-page book with yellow covers distributed to you. But if you think that the government must indeed spend money on the things described in that yellow book, then you are wrong ... In fact the explanatory memorandum has no legal meaning whatsoever. Once the monies are approved, the government will prepare the so-called real budget that may but does not have to coincide with the yellow book. And in this way it may happen that the government asks money for a horse but will buy an ass instead.

One might ask – what happens if the Budget Act is not respected? My answer is: nothing.

The Budget Act adopted as a law is being violated all the time, but there are no sanctions following, nobody is penalized. Thus, in compliance with the state budget does not seem like a violation at all. Or, paraphrasing Estonian film classics – the state budget is not a law, it is just like a law. “Like this island is not quite an island, it's more like a peninsula...” If the state budget which is adopted as a legal act and which is the most important instrument in the whole country for any given financial and political year, if it can be fearlessly violated, then why do we expect respect for the regulations, orders and other secondary legislation of the Government? Hence - every time the Government appears here before you with the draft state budget for the next year, ask the Government first what they have done with the money that was entrusted to them last year on behalf of Estonian taxpayers.

Dear audience,

Everything starts with the preparation of the same state budget. Take a look at the new budget and try to elicit from the government answers to the questions that anyone interested in the prudent use of his money would ask.

These questions are: what is to be achieved, what will be done to achieve the objectives and what will it cost.

The government's work on the budget can be evaluated according to whether these three questions are answered. And if they are, then next year, again, the government should be asked: did you attain the objectives; did you do what was intended; did it cost as much as you reckoned.

Today, however, answers to these questions are truly blowing in the wind, although this is the way the government should report to you, honourable Members of Parliament.

The NAO has also analysed the reports on the implementation of the programmes of government agencies but these reports are extremely varied as to their quality. It cannot be judged whether the outcome described by the agencies was really achieved. Targets have been formulated as activities, and not as a situation to be achieved – this implies illogical reasoning.

For instance: one of the goals of the Ministry of Economic Affairs and Communications was to develop a housing policy. And the outcome for this objective was participation in the seminar on housing policy in the European Union and Canada.

Furthermore, a goal for the Ministry of Agriculture was to increase the rate of employment among rural population. The outcome for this objective was quarterly reviews of statistical data. And so on and so forth.

To conclude with,

It is the duty of the NAO to tell whether the annual report of the government presents a true and fair view of the financial position of the government and the significant events in the previous budgetary year. I can confirm – in recent years the government's report has become more substantial, informative and true. Unfortunately, the report is not consistent with the internationally accepted principles. However, the situation is not hopeless – with the NAO encouragement essential requisites for the emergence of high-quality financial reporting have been created and the enforcement of corresponding legal acts will start next year. It has to be pointed out that it was almost the very first time after the restoration of independence that the government earnestly discussed the observations made in the NAO annual report. In addition, the government has approved the programmes of the ministries that outline specific actions for tackling one or another problem. Independence allows the NAO to offer assistance to the Parliament in seeking rational solutions. The NAO has a definite partner in the Parliament – the Committee for budget control, in cooperation with whom we can improve our government.

Honourable parliament,

As a spokesperson for the prudent use of money, the NAO supports in all respects the combination of three R-s, or "R" cubed ... And Estonia will benefit, if those three R-s stick and function together, regardless of any external temptations. Those three R-s are

"RIIK" (government), "RAHA" (money) and "RATSIONAALSUS" (rationality).

Thank you for your attention.

## **Auditor General's reply to the inquiry by the Members of Parliament Tõnis Lukas, Helir-Valdor Seeder, Andres Herkel, Tunne Kelam and Peeter Tulviste concerning the grain theft from the Rakvere Granary**

**In the Parliament, on 10 May 2004**

Honourable Chairman, distinguished inquirers, dear Members of Parliament,

The inquiry I'm about to reply concerns the public stocks. The inquiry was provoked by the theft of the security stockpile of grain stored in the Rakvere Granary. As we know today, this was followed by the thefts of rescue equipment and outfit under the control of the Ministry of Internal Affairs and the absence of grain belonging to the security stockpile also in Tamsalu Mills. It is truly regrettable that such things could take place.

When reading comments about the thefts I have been greatly disturbed by the many remarks that the rescue equipment was old and was to be written off soon anyway and that perhaps we don't need stocks of such volume and kind at all. A theft of public stocks is still a theft and it should be regarded very seriously and the discussions about the volume or the function of stocks are unacceptable.

As an introduction, I would like to add that it is in the interests of the national security to respond to emergencies and major accidents promptly and with adequate means. In emergency situations, it is essential to ensure the functioning of vitally important sectors and the protection of infrastructure. In order to respond to the emergencies and to deal with the consequences it is necessary to have also supplies additional to the resources used in normal situation. The establishment of such stockpiles must be based on risk analysis; it must be carefully considered what and how much do we need in critical situations and how to use it most prudently if the need arises. And when these decisions have been made, the acquisition as well as the preservation of the stockpiles must be ensured.

I will now answer the four questions in the order they were asked by the inquirers on 31 March.

### **1. What is the volume of strategic reserves at the moment in Estonia and where are they stored?**

The issues related to national stockpiles are regulated by the National Stockpiles Act. The Act determines the classes of national stockpiles and the procedure for their administration, regulates relations which arise from the establishment, storage, replenishment and use of national stockpiles and provides for liability in the case of violation of the said Act. Pursuant to the this Act, national stockpiles are the aggregate of tangible resources and technical means which ensure the security and independence of the Republic of Estonia and which are used in an emergency or during a state of war.

The national stockpiles of the Republic of Estonia are the security stockpiles, undertaking operation stockpiles, mobilisation stockpiles and municipal stockpiles.

The security stockpile is the aggregate of resources at the disposal of the state which is used to ensure the survival of the population in an emergency and to satisfy the needs of the Defence Forces during a state of war. The National Stockpiles Act determines the ministries that organise the security stockpiles:

Ministry of Agriculture, for foodstuffs;

Ministry of Social Affairs, for medicinal products and medical supplies;

Ministry of Internal Affairs, for fire extinguishing and rescue equipment and outfit.

The classification and volumes of security stockpiles are state secret.

The Ministry of Agriculture organises the administration of the security stockpile of foodstuffs (food grain, preserved food etc). The Ministry has concluded commission and deposit contracts with AS Eesti Viljasalv and AS Riigiressursside Keskus for the storage of the stockpile. According to the accounting data, the value of foodstuffs at acquisition prices as at 31 December 2003 was over EEK 80 million; due to the grain theft, the volume of the stockpile was actually smaller.

The Ministry of Social Affairs organises the stockpile of medicinal products and supplies and has concluded a contract with Tartu University Hospital for the storage of the products and supplies. The value of the said stockpile as at the beginning of this year was over EEK 4 million.

Ministry of Internal Affairs organises the security stockpile of fire extinguishing and rescue equipment and outfit, including gas masks and various appliances. The supplies are stored by different militarised rescue units. The value of the stock at acquisition prices is a little more than EEK 1 million. The stock has not been replenished in recent years and it must be probably written off in the coming years.

I won't go into details of undertaking operation stockpiles, mobilisation stockpiles and municipal stockpiles, the more so that they have practically not been established.

Additionally, several other legislations provide for the establishment of different stocks.

Pursuant to the Minimum Stocks of Liquid Fuel Act, the state must establish stocks in 5 day's worth. The Health Services Organisation Act sets out that regulation of the Government of the Republic shall determine the terms and amounts of and procedure for the establishment of the operation stockpile of medicinal products and medical supplies of health care providers. From the state budget of 2003, EEK 1 million was allocated to the Health Care Board for the acquisition of the operation stockpile of medical products. The Health Care Board used this money to conclude a contract with four hospitals for the establishment of operation stockpile.

## **2. What does the Auditor General plan to do in order to ensure the strategic national stockpiles? Has the presence of these stockpiles been verified this year?**

Before moving to the activities of this year, I would like to make a few comments about our previous audits on this topic. I will elaborate on the recent audits on the security stockpile of grain, given the fact that in monetary terms, this class forms the major part of national stockpiles.

In the course of a separate audit conducted in 2001, we assessed the organisation of the accounting of security stockpile of grain in the Ministry of Agriculture and the use of money related to the security stockpiles in AS Eesti Viljasalv. We drew the Ministry's attention to the absence of the approved minimum and maximum quantities of security stockpile of grain required by the National Stockpiles Act and to the fact that the accounting of stocks in the Ministry's accounting documents is not properly performed. The accounting has been adjusted by now, yet the approved quantities are still absent. We pointed out that public money used for the replenishment of stocks cannot be kept on the account of a company and raise the latter's revenue. In response to the proposal by the NAO, AS Eesti Viljasalv transferred more than EEK 48 million to the account of the Ministry of Agriculture; as of this year, the transfers in the replenishment of stocks are made through the State Treasury. The loans to grain growers from the security stockpile funds were also put an end to.

In the audit report on the economic activities of the Ministry of Agriculture in 2001, we drew the Ministry's attention to the differences in the data of the annual inventories of the security stockpile of grain and the accounting data. The quantities of grain shown by the data of annual inventories were smaller than they should have been. Regrettably, the Ministry's response was a mere formality. The Ministry hasn't approved the procedure for grain inventory to this today. The representative of the Ministry of Agriculture has participated in the annual inventories organised by AS Eesti Viljasalv in the storage facilities for grain. Despite the fact that the inventories were made only once a year and the depositaries knew about them long beforehand and despite the fact that no procedures had been established, this did not raise any questions in the minds of the Ministry's employees.

In the audit report on the economic activities of the Ministry of Agriculture in 2002, we drew the Ministry's attention to the fact that the sale prices of the grain sold in the course of the replenishment of the security stockpiles of food grain are constantly lower than the acquisition cost of the stocks.

The constitutional duty of the Auditor General is to present to the Parliament an overview on the use and preservation of state assets. Last autumn when we were preparing the overview to be presented to the Parliament in 2004, we found on the basis of risk assessments that the issues concerning the national stockpiles should be viewed under a separate section. To that end we planned several audits for 2004.

An audit on the "Formation, replenishment and preservation of the national stockpile of grains" is currently being conducted and it is scheduled to be completed by July. In March and April, an NAO's auditor participated in the inventories of the food grain belonging to the national security stockpile in all the elevators. On the basis of the inventories, the exact amount of deficits was determined – the deficit in Rakvere Granary was 14.2 thousand tons in the value of EEK 26.8 million and in Tamsalu elevator 327 tons. In the course of the audit, the NAO analyses the internal audit measures applied by the Ministry of Agriculture and AS Eesti Viljasalv, analyses the principles of choosing the stockpile depositaries, audits all the transactions made for the establishment and replenishment of stocks and evaluates the accuracy of the accounting of stocks.

An audit on the "Formation and replenishment of the stockpile of medicinal products" is being conducted and will be completed also by July. In the course of the audit, the NAO assesses the security stockpile of medical products, operation stockpile of medical products and the use of money allocated for the acquisition of medicines against tuberculosis, organises inventories for verifying the presence of stocks, assesses the internal audit system concerning the establishment and storage of stocks.

The inventories of foodstuffs, fire extinguishing and rescue equipment and outfit stored in AS Riigiresursside Keskus and the assessment of the condition of stocks are made in the course of the audits on the economic activities of 2003 of the Ministry of Agriculture and Ministry of Internal Affairs respectively.

Pursuant to law, the NAO cannot state its positions and opinions concerning the results of an audit before the disclosure of the audit report. Therefore I cannot comment on the current audits in more detail at the moment.

The audit competence determined by the National Audit Office Act is wide and we don't have enough resources to regularly audit all the bodies subject to auditing. However, given the different risks concerning the stockpiles, the related activities will remain in our focus also in the future.

### **3. Who will assume responsibility for the loss of stockpiles?**

Pursuant to § 7 (2) of the National Stockpiles Act, the activities concerning national stockpiles are coordinated and supervised by the Government of the Republic. Thus the Government of the Republic as a whole is responsible for creating the conditions necessary for the establishment and supervision of national stockpiles.

The same Act determines the ministries that organise the security stockpiles. Pursuant to the Government of the Republic Act, the minister who directs the ministry is responsible for the discharge of the functions of the ministry and its area of government. Thus it is the minister who assumes direct responsibility for the disorder in the area of government of the ministry.

Today we can say that the ministers did not have adequate risk assessments concerning the security stockpiles nor the risk management measures, there was a lack of rules of procedure, the control measures for the preservation of stockpiles were insufficient and the internal audit departments did not

pay enough attention to these problems either. The specific failures to act shall be pointed out in the course of the audits currently conducted.

And one more question. The risk assessments by internal auditors of the ministries must be supervised by the government control, whose duties are performed by the Financial Control Department of the Ministry of Finance. The Government has defined the function of internal audit. I quote: "Analyses priority areas, relying on the results of annual risk assessments." Unfortunately, I can conclude only one thing – this system has not been functioning. Because what can be of greater priority than the stockpiles ensuring the independence of the state.

This does not mean that the heads and officials of agencies designated by the state to exercise supervision and the workers and members of the management bodies of state companies who have failed to perform their contractual (supervisory) responsibilities or failed to perform them as required are not in any way responsible for the loss of the stockpile.

The incident with the stockpile of grain shows that the management bodies of AS Eesti Viljasalv did not exercise sufficient supervision over the performance of the contract and are thus responsible due to the negligence related to office. Management bodies of the companies storing the stockpile of grain assume responsibility for illegal appropriation of grain as is provided in the penal code.

By now, the Minister of Agriculture has resigned and both the members and the president of the supervisory board of AS Eesti Viljasalv have been replaced. Security Police are investigating the thefts under three criminal proceedings, identifying the persons at fault.

Thank you for your time!

\* \* \*

#### **Reply to the question not answered in the Parliament due to the time constraint**

#### **4. Should the state establish additional requirements for the legal status and economic capacity of the enterprises applying for the right to store national stockpiles?**

The duty of the state is to ensure the preservation of stocks. The storage of stocks in state's warehouses does not automatically guarantee their preservation. The rescue equipment was stored in militarised rescue units but this did not prevent them from being stolen. The question is rather in the administrative capacities of the state and in effective control measures.

If stockpiles are decided to be stored under a contract in the warehouses of companies belonging to private capital, the background of their owners and the members of management bodies should be previously checked and their economic capacity should be verified constantly. The existence of security should be required from depositaries. Different control measures (sealing of depositories, unscheduled inventories in addition to the annual ones) should ensure the preservation of stockpiles.



**Auditor General's replies to the written question by Eiki Nestor, Ivari Padar, Andres Tarand and Kadi Pärnits concerning the popularity ratings of political parties commissioned by government agencies**

**In the Parliament, on 28 May 2004**

Honourable Mrs. Ergma,

I received written inquiries by Members of Parliament Kadi Pärnits, Ivari Padar, Eiki Nestor and Andres Tarand made pursuant to the Parliament Rules of Procedure Act, concerning the popularity ratings of political parties commissioned by government agencies. The questions read as follows:

1. Is it the duty of the Ministry of Agriculture and State Chancellery to commission surveys on the popularity ratings of political parties which is established in the Government of the Republic Act and the Statutes of the Ministry of Agriculture and State Chancellor, and is it necessary for the performance of the functions established?
2. Does the commissioning of popularity ratings of political parties by the Ministry of Agriculture and State Chancellery for the funds from the state budget, or in other words, for tax payers' money comply with the State Budget Act of 2004?
3. Is the commissioning of popularity ratings of political parties by the Ministry of Agriculture and the State Chancellery a) legal, b) effective use of taxpayers' money which is subject to assessment by the National Audit Office as provided for by § 3 of the National Audit Office Act?
4. Did the Ministry of Agriculture and the National Audit Office (probably a slip, the inquirers have meant the State Chancellery?) disclose the materials pursuant to the Public Information Act?
5. If the answer to the four previous questions is not simply "yes", then who assumes responsibility for such actions and what is this responsibility about?

The NAO has not audited the activities of the Ministry of Agriculture and State Chancellery related to the commissioning of surveys on the popularity ratings of political parties. At the moment I have at my disposal the contracts on the basis of which the surveys were and are commissioned, but not the information about who has made the decision to commission the surveys and on what grounds. Therefore the NAO cannot give an adequate assessment of the responsibility of persons.

If the duties of employment have not been properly performed or if the state has incurred unnecessary expenses, it should entail responsibility. Yet the faults must be established and penalty imposed by the head of the agency. In case of doubt, thus, the members of the Parliament should require an assessment from the government and the heads of the government agencies.

The general opinion on the use of budgetary funds or taxpayers' money for one or another purpose should also be given by the legislator, i.e. the Parliament. In the case in question, the NAO finds that discussions and potential decisions in the Parliament concerning the use of budgetary funds of government agencies for the assessment of the popularity of political parties would be in the interests of clarity and solutions.

Given these circumstances, I will now answer the questions in the order they were asked:

1. Pursuant to the Government of the Republic Act, the State Chancellery manages the operations of and provides support services to the Government of the Republic and the Prime Minister (§ 77 (1) 1) of the Government of the Republic Act).

§ 8 (1) of the Statutes of the State Chancellery establishes: “For the performance of its functions, the State Chancellery shall ensure the organisational, economic and technical conditions for the operations of the Government of Republic and the Prime Minister.” § 22 of the Statutes specifies that the activities of the State Chancellery include monitoring of the public opinion. Pursuant to § 22 (3) of the Statutes, one of the structural units of the State Chancellery is the Government Communication Office, which monitors and analyses public opinion, manages public relations of the Government of the Republic, the Prime Minister and the State Chancellery, manages national dissemination to citizens of information relating to the European Union and coordinates the work of press offices of government agencies.

§ 64 of the Government of the Republic Act lists the following activities as the area of government of the Ministry of Agriculture: drafting and realisation of national agricultural development plans and effectuation of corresponding measures, regulation of activities related to the processing of agricultural products, agricultural market regulation, the national stockpiles of basic grain seed and food grain, food control and supervision, plant protection, veterinary medicine, animal and plant breeding, land improvement, organisation of agricultural research, education and training, and the preparation of relevant draft legislation. § 6 of the Statutes of the Ministry provides that the principal function of the Ministry is to provide advice to the Government of the Republic in the matters concerning agriculture and rural life, make proposals, and implement agricultural policies and rural policies within its sphere of competence.

Pursuant to the contract concluded between the State Chancellery and AS Emor on 6 February 2004, the survey (which is conducted on a current basis and whose reports shall be presented to the contracting entity, i.e. the State Chancellery twice a month) covers two aspects: support for the Government of the Republic of Estonia (clause 1.3.1) and support for Estonian political parties (clause 1.3.2). The Ministry of Agriculture concluded a contract with a sole proprietor Marti Taru on 22 March 2004 to conduct a survey “The image of Ministry of Agriculture and rural life among Estonian urban population” with the purpose of learning about the expectations of residents of cities towards the rural life and agriculture in general. Among other questions, the survey included also questions not related to the general purpose of the survey or the performance of the principal functions of the Ministry of Agriculture. For example, “For which party’s candidate did you vote for in the election of the parliamentary assembly in 2003? If the elections of the parliamentary assembly were to take place next Sunday, for which party’s candidate would you vote now?”; “Which parties should be represented in the Government of the Republic of Estonia?”; “In your opinion, which party would be the most suitable to direct the Ministry of Agriculture?”.

In the opinion of the NAO, the functions of the State Chancellery and the Ministry of Agriculture as state agencies do not require the commissioning of surveys on the popularity of political parties. Good governance distinguishes between the administrative and political levels when exercising state authority. Surveys on the popularity of political parties and the information thus obtained do not provide a substantial basis for better governing at administrative level.

The aim of the reform of the financing of parties during the last amendment of the Political Parties Act was not to add to the stability of the financing of parties. This is expressed also in the Government’s explanatory memorandum to the draft Act. Hand in hand with the growing allocations from the state budget, the parties should be capable of monitoring the popularity of their activities with their own resources. According to good European practice, such surveys are commissioned by parties, media or institutions of the third sector (research institutions), or they are conducted by survey companies, who then market them to the said customers. Political parties, private or third sector are naturally free to conduct or commission such surveys.

Public opinion surveys, monitoring and analyses commissioned by the Government or government agencies should be limited to the opinions on the activities of the Government or government agencies and/or to the surveys on specific problems of the area of government.

2. The State Budget Act of 2004 does not determine the operating expenses of government agencies with such precision. The State Budget Act of current year cannot determine the exact target of expenses and it would be neither expedient nor possible. The NAO holds that the state budget cannot prescribe which specific surveys and at which price can one or another Ministry or other government agency commission.

The general trend in the development of fiscal policy in Estonia has brought the making of such decisions from the Parliament level, i.e. the annual State Budget Act level to the Ministry level.

The functions of state agencies, including government agencies are determined by laws and statutes of the agencies. The State Budget Act allocates to the state agencies every year the amounts necessary for the performance of their functions.

Pursuant to § 25 (1) of the State Budget Act, a minister does not have a right to change the purpose of the expenditure prescribed in the state budget; pursuant to subsection 2 of the same section this can only be done by amending the state budget. The legislator has thus provided that allocated money must be used for specific purposes.

Taking account of the main principles of good governance and the obligation of transparency in the use of taxpayers' money, the NAO finds that the expenses which are not necessary for the performance of agency's functions do not comply with the State Budget Act of current year. The State Budget Act provides for operating expenses of government agencies and the ministers or other heads of government agencies must monitor whether the expenses to be incurred correspond to the agency's functions and how to perform these functions most economically.

It must be borne in mind that the State Chancellery has been commissioning surveys on the popularity of political parties for quite some time. But the Government should take a firm position and put an end to further surveys commissioned by government agencies.

3. The answer to the previous question included the opinion on the legal use of taxpayers' money.

It follows from the foregoing that surveys on the popularity of political parties organised by government agencies cannot be deemed to be effective use of taxpayers' money, since the money has been used for activities unnecessary for government agencies. Moreover, in this specific case, the NAO sees the commissioning of surveys of similar content by different state agencies practically at the same time as wasting or ineffective use of money, given the fact that the price of surveys depends on the volume of the questionnaire and that their impartiality is guaranteed by the entity conducting the survey. The survey commissioned by the Ministry of Agriculture includes questions that repeat the questions asked in the surveys commissioned by the State Chancellery on a regular basis.

4. The director of the Government Communication Office has publicly admitted that due to a human error, the disclosure of materials did not fully comply with the Public Information Act. This means that the results of the surveys which are, according to the contract, submitted to the State Chancellery twice a month, were not published on the website at once. Yet the Public Information Act says that information must be disclosed on the website and it can be published elsewhere as well, e.g. in printed press.

According to the contract, the Ministry of Agriculture received the commissioned survey on 5 May 2004. The Ministry informed the public about the survey on its website on 11 May; the survey was presented also in a press conference held at the Ministry on 12 May. The survey itself, however, was published on the webpage only on 14 May.

The Public Information Act provides that public information is required to be published on the webpage "in a manner which ensures that it reaches every person who needs the information as quickly as possible". The NAO finds that this requirement was not adhered to neither in the State

Chancellery nor in the Ministry of Agriculture, where it would be correct to publish the survey together with its press release.

5. The NAO has not audited the problems raised by the inquirers or performed procedural acts as defined in the National Audit Office Act. Therefore the NAO does not have at its disposal all information concerning the activities of the officials of the State Chancellery and Ministry of Agriculture in the given case and thus the NAO cannot form an opinion on the liability of the officials.

The general principle deriving from the Public Service Act is that persons who have failed to perform their duties as required or caused unnecessary expenses to the state, assume responsibility as provided for in the law.

## **National Audit Office – a wolf in sheep’s skin or a sheep in wolf’s skin? Choices and challenges**

### **Speech of Auditor General, Mihkel Oviir at a conference dedicated to the 10th anniversary of the Law Office Paul Varul on 28 October 2004**

The other day at home as I was making a fire in the fireplace, I came across the weekly *Eesti Ekspress* from 1997. Instead of using it as a firelighter, I began to read it, for browsing through old newspapers is captivating. They often reveal totally new aspects of an event that remained unnoticed at the time of the event.

In that *Eesti Ekspress*, in the section called “Kranaat”, there was a joke about the National Audit Office. It reads as follows: A robber enters the Bank of Estonia, with a gun in his hand. With all that noise, the President of the Bank, Vahur Kraft rushes in, looks around, sees the robber and says with a sigh of relief: “Oh God, it’s you... I feared already that it is that damned Sven Potapov from the National Audit Office.”

Back then, seven years ago, being the Secretary General of the Ministry of Justice, I didn’t understand the joke the way I do now, being the Auditor General.

Now I know from my own experience the image and the attitude that this joke, although based on a very specific incident, subconsciously conveys and expresses. As a side remark, let me remind you that at that time there was an intensive discussion with a political flavour to it concerning the right of the National Audit Office to audit the Bank of Estonia.

We could see the same kind of discussion going on throughout 2004 – to which extent, if any, has the NAO authorized to audit local governments – and again, in addition to the rational side, there is also a distinct political dimension to it. Both legal and political arguments are sought against the auditing. And if rational arguments run short, emotional ones are brought into play.

The local governments were tried to be convinced that now that the National Audit Office is coming, they’re done for. And when we tried to explain that we only come to help, they did not believe us but the intimidators. After all, it is a well-known saying that the audit begins with two lies: the auditor claims that we came to help you and the audited body replies that we have been waiting for you long and we are glad you came.

### **Haunted by false images**

For various reasons, our statements about our friendliness remind several audited bodies the tactic known from the story about the big bad wolf and three little piggies. Remember, the wolf tried to get

into the piggies' house by putting on a sheep's skin and baaing gently, and when this didn't work, he started to blow down the house. This is probably how we are perceived as well.

But is it really the aim of the National Audit Office to creep up on like a wicked and sly wolf clad in the skin of a lamb and get its mouthful and commit its evil deeds? Or do we have a different aim? Or perhaps the National Audit Office is a rather feeble lamb who only appears to be a powerful and scary wolf? Analysing these two extreme images can help to get a better view of the essence and role of the National Audit Office in the society.

We receive constantly very many letters, petition and requests where the citizens express their concern. When looking at those letters, one gets an impression that people want to see us rather as a wolf. And what to we do? We reply usually with an apology that your problem is not within the sphere of our competence, we cannot help you to solve it, we can forward your letter etc. etc. etc.

Hence, it is not surprising when these people ask why we need such an organisation as the National Audit Office at all. Why do we need it, if it does not come and enforce the justice with its iron hand? People expect that when they turn with their problem to the National Audit Office, which they see as their last resource, it will be solved. But as it usually won't, they might become disappointed.

When I explain to people that the National Audit Office is actually a classical audit institution, it unfortunately does not say much to most of them. Yet various surveys show that the NAO is seen as a reliable institution. Why? I try to answer this question by giving you an example from the book called "Yes, Minister," which is also known as the Bible of public servants.

Remember the chapter where the minister wanted to sell his art gallery at his electoral district in order to get money to support a local football club? One rather demagogic counter-argument by Sir Humphrey Appleby was that even though people don't go to this art gallery and nobody really needs it, people are calm knowing that the art gallery is there. Whether people go there is a very secondary matter.

The effect of the NAO is somewhat similar to this art gallery. People feel calm just knowing that we exist: somewhere is an institution whose function is not perhaps perceived very clearly, but there is this feeling that it creates. Although people live without knowing the essence of the NAO, they are still calm knowing that this institution exists.

One cause of the illusory hopes is definitely our name – National Audit Office (Riigikontroll). The very word 'audit' implies a certain element of repression and people conclude that the National Audit Office should be in its essence a very big, strong and powerful institution.

This word creates also illusions that we have and should have repressive means which help to ensure the implementation of our decisions and opinions. This name was entered to the Constitution for historical reasons. I believe that it is not the most appropriate one, since it retains the repressive image. It is true that until 2002, the NAO had some repressive elements to it. Ignoring our decisions could entail administrative sanctions.

It takes long before the actual and present function of the NAO will be acknowledged – this image of the repressive body is still strongly rooted somewhere in the back of our minds. In all of us, up to the legislator.

When I was making my annual speech in the Parliament, most of the questions the honourable Members of Parliament asked me can be summarised as follows: yes, what you say is absolutely true, but please tell us which further functions, which further rights do you need so that you could enforce your proposals. Do say which laws need to be amended.

And as I tried to explain that in my opinion we don't really need any enforcement mechanisms, I saw bewilderment and a kind of disbelief in the eyes of many Members of Parliament. It is our task to

bring the problems before the Parliament and it is the task of the Parliament to find solutions, amend laws and regulations, demand explanations etc.

We are still haunted by the shadow of the Soviet-time institution People's Auditing Office (Rahvakontroll). I'm sure many of us remember what the People's Auditing Office meant. It was an organisation very high in the political hierarchy who literally removed people from office when necessary and without prior notice.

Today, the NAO does not enforce itself through repression but through its capability to make expert recommendations to the audited bodies and to its main customer – the Parliament.

Yet this opens up a new can of worms. The proposals that the National Audit Office makes for improving the system are generally abstract. The public, however, is more interested in focusing on very specific problems. One case is being viewed and discussed, but usually no-one wants to look what is behind it, what is causing the problem.

We often fall for this attitude. Of course, it is very good and easy to say that this and that much grain was stolen from the Granary. This is a definite fact. This is a specific act which has been widely discussed.

The questions how it could happen at all and what caused it have been discussed much less. People who are dropping single facts are only trying to draw attention to themselves; making a fuss about single facts is in. They won't bother themselves with systematic thinking and systematic approach.

### **Under the influence of (lack of) political culture**

In a situation where the National Audit Office does not possess any repressive means, the level of political culture is very important. Very many problems here are similar to those of the Chancellor of Justice: there is a constant threat of being accused of interfering in politics. When we look at who is accusing us, it is usually the coalition. The opposition has never accused us of interfering in politics. It is not pleasant if such a universal sword of accusation of political interference is constantly held above your head.

In that sense, the position of the National Audit Office is even a bit more difficult than that of the Chancellor of Justice, since we have a case where the former Auditor General has gone into top politics. Together with him and also later, several workers of the NAO went to be political advisers in ministries. All their deeds done in the NAO are now seen through this prism; it is believed, that these were the prerequisites for going into politics. We have to pay for that even today: it is as if we must be able to constantly prove that our proposals have nothing to do with political struggle.

I am convinced that it is impossible to say when an official is governed by political considerations and when he is not. According to a classical scheme, it should be this way that politicians make decisions and the officials are merely the tools for implementing the political will.

Yet in reality it is obvious that every official shapes politics, whether he wants it or not. Anyone who is making even the slightest decisions or shaping our legislative policies in any way does that; anyone who is preparing draft legislation, for example, does that. Basically any official who is deciding over the use of money in one or another way is engaged in politics, for money is the central instrument for implementing politics.

So the line here is actually very blurry and perceptual. It is extremely subjective, because it is impossible to objectively ascertain whether one or another decision is made on political considerations or not.

I, too, have come across the issue of politicized civil servants. I know I have many opponents in this matter, but I am convinced that since officials do have political convictions, they might as well be

allowed to join a political party. It is not a shame to have certain convictions and let everybody know it. Precisely the fact that his political views are known would restrain the official, since it would increase public scrutiny over his decisions and actions.

But lately I have also come across the downside of becoming politicized. There was a certain case in our practice where an audit of the NAO, concerning an official who has very clearly identified himself politically, was sharply attacked.

A question arose whether the NAO, when giving its opinions, should start taking account of the political party to which one or another official, under whose responsibility the problem is, belongs. The answer is a definite no. I hope that it was a single fact, an incidental derogation from the norm.

If this becomes systematic, it is a dangerous indicator. One cannot tolerate the political culture where the leaders of political parties protect a feckless or failed official in the interests of the party only.

Thus, whether the political affiliation of a civil servant is beneficial or harmful depends again on the political culture. Given the current level of political culture, however, I cannot imagine the situation where for example judges would belong to political parties. And not really because I would suspect that a judge belonging to a political party would be somehow influenced. If a judge belonging to one party would have to administer justice to a politician belonging to another one, then however fair and just the verdict, it would still be placed in doubt before the public. This in turn will undermine people's faith in the independence and impartiality of the court system.

Unfortunately we have to bear in mind that in political terms, Estonia is divided. If you look, for example, how respected people form conversation groups at the reception of the President of the Republic, you can see that they form into groups mainly according to their political affiliation. I'm afraid Estonia is not Great Britain where the Members of Parliament attack each other sharply in the Parliament chamber, yet go and have a pint of beer together afterwards.

### **Out of the black hole**

For many years it seemed as if the audits of the National Audit Office disappeared into a black hole, because the Parliament was not up to being a reliable partner. In 2004, however, the Parliament set up a Budget Control Committee to improve the co-operation with us.

Such committees have been set up in most countries. It is this committee that is our input, our channel through which we can with our rational analysis and proposals support the formation of most reasonable political decisions.

Yet, one particularity must be borne in mind in the case of this committee – it should be led by the opposition. Traditionally, such committees are led by someone from the opposition and the majority of the committee members are also from the opposition. Why? Because the opposition is interested in raising problems. I dare not to claim that the opposition is always interested in finding a solution to such problems as well, but they often have to show a strong desire to solve them. And this is already something like the principle: better half an egg than an empty shell.

Estonia, too, has such a committee now, but in the current political situation, the line between the coalition and opposition is fairly fuzzy. This, however, is clearly and purely a political issue, which has to be solved by the Parliament itself.

The National Audit Office cannot disregard the political culture. We can be only as effective as the existent political system and composition enables and wants us to be.

If one or another issue is not paid enough attention to in the Parliament, the NAO has also another channel to make itself heard. It is the publicity. Our reports are public and public disclosure is often feared more than any administrative sanction.

We cannot take responsibility for what is happening in the state, but we can take responsibility for bringing the information before the Parliament and the public. We are the ones holding a mirror in front of the Estonian state, so that the state could see its real face.

### **Integration with the world**

The National Audit Office is not alone in the world; we are a part of the global network of supreme audit institutions, we are one of the organisations most integrated with the world. In October 2004, a congress of the supreme audit institutions was held in Budapest with more than 180 participating countries from all over the world. We are developing common policies, common working rules, common methods etc. Where necessary, the world's supreme audit institutions provide each other assistance, and this assistance has become of vital importance to the Estonian NAO.

In a world that is becoming more and more complex, we face the acute problem of competence. No longer can we have total competence. It is not the problem of small countries only, but it concerns the bigger ones too. If a British or German Auditor General complains that they have great difficulties in finding auditors who would be competent for auditing information systems, for example, it very clearly demonstrates the problem.

Therefore, the work of supreme audit institutions is more and more project-based. The need for external knowledge is growing every day. The Estonian NAO has to start buying in certain knowledge that we don't have in Estonia from foreign states.

In 2004, we audited road repair works; the next audit related to roads should be on the quality of the roads. Why does this cause problems? It is because we cannot find an expert on road quality in Estonia who would meet the two requirements that are of utmost importance to us: competency and independence. After all, all our road-experts have studied in the same school and everyone knows everyone. This is not a problem peculiar to Estonia only: our colleagues from Slovenia were facing the same problem. Eventually, they got an expert with the help of the Austrian NAO.

Thus, in the process of globalisation, we have reached the stage where the activities of the Estonian NAO reflect in the activities of other supreme audit institutions and vice versa.

### **In search of inner balance**

In this changing world, the NAO asks itself the question who we are and how do we operate all the time. Therefore, the question of the wolf and sheep I touched upon in earlier is without a doubt one of the central ones. We don't want to be either of them, we need to find the balance. In this sense, we should have the character of a sheepdog: in a way, it protects us from ourselves and at the same time does not let us turn into a big bad wolf or a futile and feeble grass-eating lamb.

We are the representatives of such professional culture who do not see repression as the main instrument for ensuring a civilised country. On the other hand, I find that the Parliament as our main customer should be willing to listen to the rational proposals of the NAO and it should also be willing to take rational actions necessary for the realization of these proposals.

We operate in an environment where political decisions and common sense clash very often. Unfortunately, common sense cannot always prevail in public sector, because it is in the human nature to think in fairly emotional terms. Given this context, our role as a balancer is even more important, because we do not depend on the votes of the electors. The state becomes better if the emotional and rational side are kept in balance.



## 5. Opinion on the NAO internal control system

As the Auditor General, I find that the NAO internal control system is efficient, i.e. the system is effectively operational, conforms to the rules of procedure, and ensures the agency's legitimate and economic performance and the protection of resources.

The NAO internal control system includes structure, management attitudes, applicable procedures and other measures providing reasonable assurance that:

- the Office's operations are legitimate;
- the Office's assets are protected from damage resulting from wasting, unintended use, fraud, incompetent management, etc;
- the Office conducts its business economically, efficiently and effectively, and ensures high quality of services;
- the management and financial information reflecting the Office's business is reliable, accurate and timely.

The NAO has established statutory and internal rules of procedure which are respected and monitored as to compliance. The separation of duties has been ensured in the performance of the Office's functions and in the documentation and authorisation of transactions, and supervision is exercised.

Mihkel Oviir

Auditor General

## 6. Signatures to the annual report

The NAO annual report for the financial year that ended on 31.12.2004 consists of the management report and annual accounts.

The management report and the annual accounts have been drafted by the executive management of the NAO. The Auditor General and the Director have examined the annual report.

Mihkel Oviir  
Auditor General

Tõnis Saar  
Director of National Audit Office