

RIIGIKONTROLL

Annual Report 2003



Tallinn 2004

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RIIGIKONTROLL



Dear Reader,

For the State Audit Office, the year 2003 was quite usual. Just like everything else evolves around us, so evolves the State Audit Office – maintaining old values while renewing itself. Only the organisations that continue the processes that have been commenced and introduce some new elements in an appropriate proportion can be successful. So they avoid stagnation, as well as failures that result from excessive unfamiliarity and uncertainty.

Our routine of work followed the established lines of activity. The State Audit Office has audited the use of taxpayers' money for four years in the form of different types of audits. The subsistence of fundamental principles provides auditors with a feeling of security, enables them to generalise various phenomena and to observe and influence developments in the spheres that they audit.

The formation of sphere-based work teams in departments has proven to be an efficient method of work. Whether audits of public procurements in the Department of Audit of Operational Risks, audits of the sphere of business in the Performance Audit Department or division of work on the basis of ministries in the Financial Audit Department is the case — this report demonstrates that the performance results of the State Audit Office justify such an approach to auditing work. The division of work on the basis of spheres and the specialisation of auditing teams are like a fine wine that improves over years, accumulating competence and enabling auditors to draw conclusions that reach beyond individual audits.

While maintaining organisational stability, we faced the formation of new duties and directions of work, which the State Audit Office will have to tackle during the following years, perhaps even decades.

Estonia's accession to the European Union is certainly one of the most significant changes that affect the State Audit Office – besides our obligations to Estonian taxpayers we will also have obligations to taxpayers in Europe.

Better penetration into the sphere subject to auditing in Estonia, maybe even expansion of that sphere, constitutes another challenge for us. Until now, external auditing has not been a requirement for all local governments. The State Audit Office intends to concentrate more on local governments, yet while adhering to its current competence. An amendment to legislation is being discussed, by which the audit mandate of the State Audit Office would be extended and its competence to audit local governments would be increased. Exactly how that plan will be implemented has not been decided on the level of the Parliament (Riigikogu) yet. However, it is obvious that our field of work will increase and that the mere mandate will not mean much – we will have to make efforts to live up to the expectations.

We also intend to focus more on auditing legal persons under public law, as well as government-invested enterprises and enterprises founded by the state. Although legislation has always enabled the State Audit Office to audit these entities, they have not actually been included in the sphere of interest due to the risk assessments carried out in the past. It has appeared, however, that ministries are rather unenthusiastic and incapable as regards the reasonable and profitable management of these entities and therefore impetus from the State Audit Office is needed.

I deem the standing order of a select committee of the Parliament – the Select Committee on Control of the State Budget – which was processed in the year 2003 and will take effect this year, as extremely significant. To put it briefly and simply, the task of the new committee is to discuss the reports of the State Audit Office. Although it seems at first that this would render the work of the State Audit Office easier and this would allow us to hope that the voice of the auditors will not remain a voice in the wilderness, it also brings about a major challenge. What information does the Parliament expect? Will the skills of the State Audit Office be sufficient to cover the Parliament's need for information? How can we contribute to the work of the committee, and what should we request from the committee, so as to make both parties feel as working towards the same goal and being mutually useful? These are just some of the questions which the State Audit Office must seriously weigh to ensure that cooperation with the Parliament as one of our legally designated target groups does not remain just a declaration, but evolve into collaboration that can be relied upon.

The term “taxpayer” is repeatedly used in this report. That term is not an occasional one. Notwithstanding the more or less important current issues, everyday partners and the usual administration-based rhetoric, i.e. referrals to ministers, managers of administrative agencies and members of the Parliament, we must never forget for whose benefit we actually work. The taxpayer must be the measure of each and every choice. We cannot miss our goal then.



Mihkel Oviir
Auditor General



1. Principal activity of the SAO

Who does the SAO work for?

The State Audit Office is the 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 State Audit Office are first of all addressed to the Parliament, the Government and the general public.

The closest 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 State 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 a framework for discussions, on the other hand the Parliament evaluates (on the basis of the information submitted to it by the State Audit Office) how in spending public money the Government has abided by the will of the people's representatives, i.e. laws. Being based on audits carried out during a year, the State Audit Office 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. Preparing such reports is one of the constitutional obligations of the State Audit Office. However, we deem confining ourselves to these reports as insufficient and have therefore tried to attract more in-depth attention of the committees of the Parliament with individual audits, as well. Time will tell whether the newly established Audit Committee within the Parliament will improve relations with the Parliament and enhance substantial supervision of people's representatives over the executive power.

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 State Audit Office are brought to the general public via the Internet and media.

Both the Constitution and the State Audit Office Act declare that the State Audit Office 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).

At the end of the previous year, we initiated an audit of remuneration paid to members of management boards of government-invested enterprises – not as a result of a merely occasional scandal but rather due to the circumstance that the issue has become a social “pain spot” and we sensed the need to render an opinion on it. Once a minister has decided that an activity or entity needs to be audited and the risk assessments of the State Audit Office confirm the existence of problems, an audit is commenced. We also expect members of the Parliament to forward their suggestions as regards the audit plan.

In the international usage, institutions like the State Audit Office are also 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 State Audit Office 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.



September 1, 2003. Mihkel Oviir, the Auditor General, delivers to Ene Ergma, the President of the Parliament (Riigikogu), “The overview on the use and preservation of state assets in the year 2002.”

1.1. Financial audit

The year 2003 was a year of stable growth for the Financial Audit Department; the goals to be achieved had been established four years ago. Several audits were carried out in conjunction with experts from the Court of Auditors of the Netherlands and the State Audit Office of Denmark who explained their methods of work to our auditors. By now, the development of financial audits has reached the point where in addition to the evaluation of the correctness of annual reports we also render a general evaluation of the legality of economic transactions.

Extension of the scope of audits places more requirements on the competence of auditors. We deemed it reasonable to divide the department into five work teams on the basis of the areas of government of ministries in the previous year. If the entire team, from the audit manager to the junior auditor, monitors the problems of the designated sphere year in-year out, the work of the team will definitely speed up and the auditors will have more time for more in-depth investigation into problematic matters. Furthermore, specific, sphere-based knowledge will enable auditors to forward relevant suggestions that are useful for the auditees and ultimately for the taxpayers.

The year 2003 will also be remembered as a year in which our routine audit of the annual accounts of the Motor Vehicle Registration Centre revealed a major abuse entailing a scandal that was widely discussed in the mass media. Actually, we had already been stating for several years that unless all economic transactions of an agency are reported in the financial statements, misdeeds and abuses are extremely difficult to detect. It is regrettable that such an incident was needed to introduce changes in the organisation of accounting in state agencies. The knowledge that accurate accounting and reporting are essential to the supervision of spending has been slow to take root in people's minds and therefore it has sometimes been difficult to explain the need for the work of auditors.

However, through its audits and criticism the State Audit Office has contributed to the steady development of financial reporting in the public sector of Estonia. Government officials are on a growing basis abandoning the attitude according to which a financial audit is merely "digging in numbers," dry and boring statistics disclosing ancient events, which is of no use after some time. It is not just the budget that is managed – more and more credit is given to information about the use of the budgetary resources: how much has been spent during a year, how much has been invested, what is the value of the investments, how have the investments been managed?



Kaie Karriol
Chief Auditor



Employees of the Financial Audit Department in February 2004

First row, from the left: Ilme Ott, Airi Mark, Sven Potapov, Kaie Karniol, Ilja Šterenber, Õie Soovik, Merike Starovoitov. In the middle, from the left: Mare Kabrits, Marek Suurniit, Siiri Roose, Alo Lääne, Jüri Kurss, Krista Uuna, Aigar Mäesepp, Andrei Haritonov. Above, from the left: Ivika Vispel, Kadri-Liis Loigu, Katrin Eller, Ines Metsalu, Mari Rull, Inga Häkkinen.

Essence of financial audit

Through financial audits the State Audit Office provides the Parliament and the general public with independent and objective information on whether the Government of the Republic has spent money in compliance with the will of the Parliament (incl. in accordance with the restrictions established by the Budget Act). By the term “Government” we mean the entire government sector – ministries, administrative agencies, government-invested enterprises, foundations established by the state, and legal persons under public law.

To put it simply, a financial audit is an evaluation. Evaluations can be made with regard to various aspects of economic activities and within a varied scope – with regard to an individual agency, to an area of government of a ministry, or to the entire state.

The State Budget Act establishes the obligation of the State Audit Office to evaluate the correctness of reporting and legality of transactions of the state in its entirety on an annual basis. These evaluations are the responsibility of the Financial Audit Department. To perform that obligation we carry out annual audits in agencies and ministries such as to cover major cash flow, assets and liabilities with audits and to generalise the results on the national level.

| Effectiveness of activity | Scope of performance audit | | | | |
|---|----------------------------|------|------|------|--|
| Economy and efficiency of activity | | | | | |
| What is the quality of reporting on results? | | | | | |
| What is the level of internal control and financial management? | | | | | |
| Is information about expenses incurred correct? | | | | | |
| Have the transactions been legal? | | | | | |
| Have the transactions, assets and liabilities been accurately recorded in the accounts? | | | | | |
| | 2000 | 2004 | 2005 | 2006 | |

When carrying out the first financial audits in 2000, we evaluated the correctness of reports only.

The decision made in autumn 2003 to start working such as to render an overall opinion on the legality of transactions in the year 2004 as well did not emerge from nowhere – besides evaluating the correctness of the annual reports of agencies and the reports on implementation of the state budget we have always made observations on the legality of transactions and on financial management.

However, a financial audit is more than just an audit of the correctness of a report or an evaluation of the legality of transactions. We also intend to evaluate information about expenditures, financial management, internal control systems, and the correctness of performance information presented in management reports in the future.

Key figures of the year 2003

In the year 2003, the department worked on 43 audits. 40 of these audits resulted in audit reports. One audit was finished with a letter in the course of the pre-study, as the risk assessment was altered in the planning stage. In autumn, we commenced two *ad hoc* audits, which will be completed in the year 2004.

Being based on its audits, the department rendered an overall opinion on the report on implementation of the state budget by the state in its entirety. The audits covered 76% of the consolidated balance sheet volume of the state, 62% of the budget costs and 98% of aggregate revenues. The State Audit Office concluded that in collecting and spending money, the Government had generally guided itself by the will of the Parliament.

Essential results of auditing

Financial audits focus primarily on auditing the annual accounts of individual agencies, as this enables us to render an overall opinion on the report on the state as a whole. In addition to the opinion on the consolidated report of the state, we have reached the following general conclusions based on our audits:

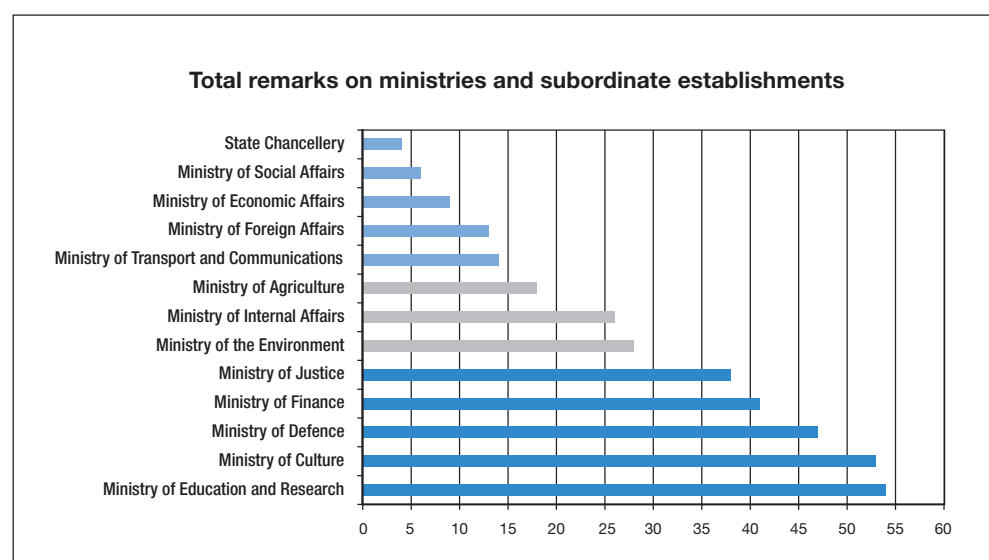
- The reorganisation of accounting in the public sector has progressed to the final stage. The amendments to the Accounting Act and the State Budget Act, and the General Rules of Public Accounting adopted in 2003, in preparation of which the State Audit Office also had its role, led us to believe that the consolidated report for the year 2004 would be characterised by a new quality, in terms of both form and substance.

- Accounting in ministries as central establishments, which has been done for three years, is basically correct. While individual offences against rules exist, the reasonableness of some rules (although adhered to) should be analysed.
- The rather good situation in the accounting in ministries is frequently contrasted by the level of accounting in subordinate establishments. Emphasis is laid on the productivity of activities, while underestimating financial accounting and overlooking the connection between productivity and accounting. The State Audit Office stresses that a minister should only be satisfied if accounting is in order in subordinate establishments as well, because a ministry and its subordinate establishments constitute a whole, and the management of a ministry includes responsibility for the management of subordinate establishments, as well.

In the previous year, we prepared a chart for the year 2002 (see the bottom of the page) where the areas of government of ministries were ranked on the basis of the total number of reprimands made in the course of our audits. Although the total volumes of consolidated balance sheets and budgets of the ministries cannot be exactly compared and therefore the monetary value of the mistakes pointed out during audits is different (e.g. the Motor Vehicle Registration Centre in the area of government of the Ministry of Economic Affairs and Communications), in our opinion the ranking list in general provides an adequate picture of the situation in accounting in the year 2003.

- While most of the ministers acknowledge criticism of the subordinate establishments of ministries, the case is different with commercial undertakings, foundations and legal persons under public law in the areas of government of ministries. It seems sometimes that responsibility for these entities has been limited to the appointment of the ministry's representative to the supervisory board of the entity concerned. Obligations of the representative and reporting on the performance of the obligations have been overlooked, though.

The State Audit Office hopes that an increase in audit experience and awareness of ministries will enable us to reduce the volume of the tables of reprimands on an annual basis, and to observe more responsibility for spending taxpayers' money.



1.2. Audit of operational risks

When the structure of the State Audit Office was altered in the year 2000 and the ministry-based approach was replaced with the structure based on different types of audits, several high-risk areas still remained whose integrated auditing seemed to be vital. Therefore, in addition to the two classical types of audit – financial audit and performance audit – the audit of operational risks was introduced.

People have been curious about the name and activity of this department both in Estonia and abroad, because the supreme audit institutions of other countries usually do not have such a department. An audit of operational risks incorporates the approaches of both financial audit and performance audit, and is commenced by ascertaining the purpose of a subsidy, activity licence or procurement, and ends with the evaluation of the particular activity or use of money.

During its first years of activity, the State Audit Office was also engaged in *ex ante* audits examples regarding which may seem quite funny these days: for example, in the year 1923 the Tallinn Customs Board requested the State Audit Office “to approve the ration of fodder for the roadster of the Customs Board as specified in the certificate of Mr. Punin, a veterinary, because the horse is young and will become lean unless fed properly, considering the amount of work.” Although we are not involved in *ex ante* audits within the meaning of that time any more, certain parallels can still be drawn as regards the general approach: it is important to avoid mistakes, instead of just stating their occurrence. However, nowadays we do not just indorse documents concerning individual transactions; instead we aim at helping to create an integrated control system for state agencies, which should anticipate and preclude any squandering, fraud and negligence.

The spheres subject to auditing have remained the same over the years: benefits and subsidies granted from the state budget, public procurements, and activity licences. Our colleagues in the supreme auditing institutions of several other countries also deem these spheres as most prone to risks. In addition, we carry out *ad hoc* audits in urgent issues.

An audit of operational risks requires comprehensive knowledge from an auditor: in addition to being competent in the field in question, an auditor must also be familiar with issues of financial management, accounting and legality. The solid work of auditors is proven by the circumstance that the number of completed audits increased in the year 2003, while the number of employees was smaller when compared to previous years. Many audits evoked positive responses in parliamentary committees, ministries and the media.



Jüri Kõrge
Chief Auditor



Employees of the Department of Audit of Operational Risks in February 2004

First row, from the left: Liisi Uder, Jüri Kõrge, Liidia Heinlo. In the middle, from the left: Saima Strenze, Olav Lүүs, Evi Riives, Pille Põder, Maidu Lääne, Tiina Ojasalu. Above, from the left: Raivo Hurt, Svetlana Rõbakova, Helen Paliale, Maret Põldaas, Margit Jaksen, Vello Kuuse.

Nature of an audit of operational risks

Audits of benefits and subsidies

In the audits of benefits and subsidies we focus on the following issues:

- Do laws and regulations establish unambiguously the purpose, recipient and conditions of the benefit or subsidy in question?
- How is the applicant's right to the benefit or subsidy verified?
- What sanctions are applied if a beneficiary or an official has violated the conditions of a benefit or subsidy?
- Is information about the conditions and recipients of benefits and subsidies available to the general public?
- Does the internal control system provide for the possibility of evaluation of the legality and adequacy of the activities of the person disbursing benefits and subsidies?

Audits of activity licences

In the course of audits of activity licences we evaluate the following:

- Do laws and regulations establish the purposes and cases of application of activity licences?
- Are the requirements placed on applicants sufficient so as to meet the objectives of application of the licences?
- Do officials treat applicants and holders of activity licences on equal grounds?
- Is supervision over the activity of licence-holders ensured and are sanctions applied if necessary?
- What is the likelihood of operation without activity licences and how has this risk been hedged?

Audits of public procurements

In auditing public procurements, the State Audit Office guides itself by the following four principles:

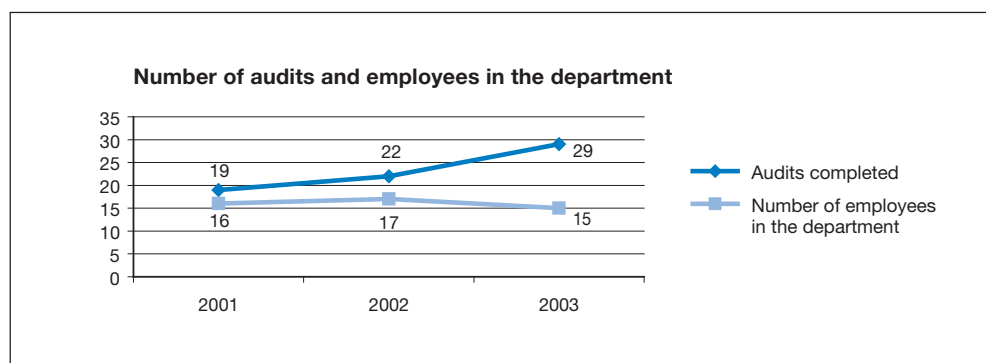
- the economic efficiency of a procurement – the thing (work, service) to be procured must meet the needs of the buyer; the price of what is procured must conform to the market price at the time of the procurement or be lower than the market price; the buyer must obtain what is procured at a time appropriate for the buyer;
- objective treatment of tenderers – all tenderers must receive similar information about the requests and activities of the buyer; the buyer may not place unreasonably high requirements on tenderers;
- the transparency of a procurement – the activities and decisions of the buyer must be objectively reasoned and understandable to tenderers;
- the verifiability of a procurement – it must be possible to retrieve the procurement procedure on the basis of the documents of the procurement.

***Ad hoc* audits**

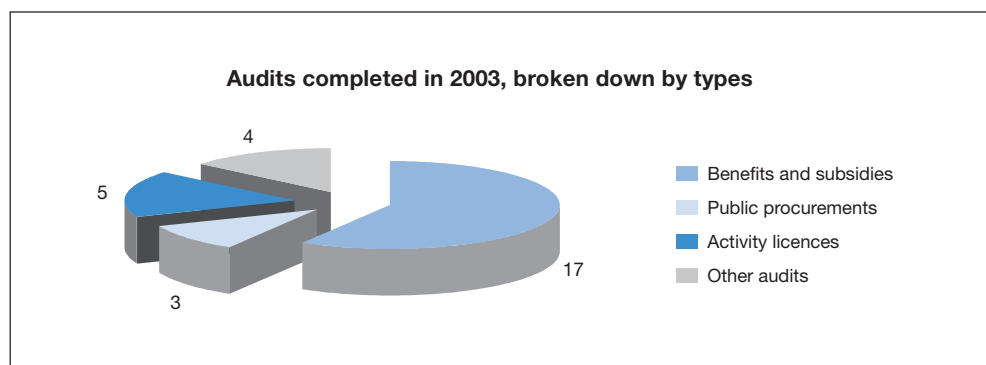
As a rule, the State Audit Office carries out audits on the basis of the annual plan approved by the Auditor General. However, information might be received during the year which refers to the need to commence an audit urgently. Such audits are carried out off-schedule, and generally by the Department of Audit of Operational Risks.

The aim of an *ad hoc* audit is to provide an expert evaluation quickly and to disclose the issue so as to preclude the occurrence of similar problems in the future.

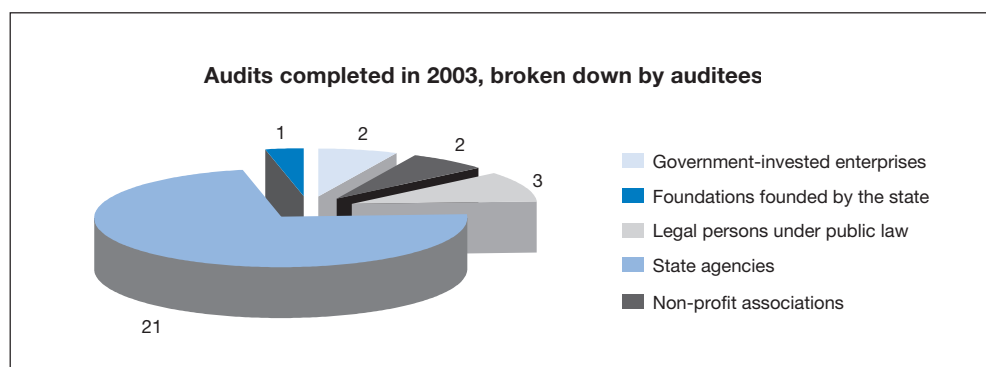
Key figures of the year 2003



In the year 2003, the State Audit Office was engaged in 40 audits, 29 of which were completed and one was carried out in conjunction with the Financial Control Department in the Ministry of Finance. In addition, our auditors participated in the work of the Financial Audit Department and in the audit of procurements carried out on the account of funds received from PHARE and ISPA, conducted by the European Court of Auditors.



In most of the cases the auditees included state agencies. However, more attention was also paid to legal persons under public law, foundations established by the state, non-profit associations, and government-invested enterprises.



The year 2003 was the first year in which we forwarded all audit reports to the Parliament (the Finance Committee) under the law.¹ A number of audits were discussed in depth, yet the Committee was rather passive with regard to some of the audits, although we had expected an explicit opinion from the Finance Committee. As regards transactions concluded during the period of dissolution of the Compensation Fund, which in the opinion of the State Audit Office had been illegal, the Finance Committee acknowledged the information provided. Owing to the complex nature of the issues, the discussion was scheduled to be continued after the summer recess of the Parliament. The discussion was never resumed, though. We also applied for an opinion of the Committee after one of our audits revealed that the Ministry of Education and Research had used a significant part of the funds envisaged for transport compensation to students to cover other expenses. The position of the State Audit Office was that the Ministry of Education and Research had violated the State Budget Act; the Ministry stated that although they had not adhered to the intended purpose established in the Act, they had still used the funds to cover education-related needs. The Finance Committee did not express its opinion on the matter.

In several cases we notified other standing committees of the Parliament of the results of our work, as well.

We forwarded a lot of proposals to auditees and, where necessary, to other ministers and heads of state agencies, most of which concerned amendments to legislation and improvement of control systems. During the second half of the year, we forwarded 183 proposals, of which 160, i.e. 87% were accepted. In other words, on an average we forwarded 12 proposals per audit. A part of these proposals were capable of being implemented immediately, others require more time, in particular the proposals that concern amendments to the legislation.

The department monitors the implementation of the proposals and of the measures intended for implementation of the proposals. If necessary, we conduct follow-up audits focusing on the actual employment of measures intended for implementation of proposals. Two such audits were carried out last year.

¹ The relevant amendment to the State Audit Office Act entered into force back in the year 2002, but audits commenced before the enactment of the amendment were completed pursuant to the procedure effective until the entry into force of the amendment. From the year 2004, audit reports will be forwarded to the Committee on the Control of the State Budget.

Essential results of auditing

Benefits and subsidies

In the overview on the use and preservation of state assets we proposed that the Government develop a good practice of payment of benefits and subsidies, defining the minimum requirements for their administration. The Ministry of Finance acknowledged that the proposal is justified, but noted that it would take time to implement it.

Activity licences

In the year 2003, we focused on activity licences issued by the Ministry of Education and Research. Three of the five audits completed dealt with the activity of that Ministry. We pointed out a number of problems in the course of all of these audits. Although the risks ascertained in connection with different audits were different, the following typical shortcomings can be named on the basis of current practice:

- either the need or sufficient legal basis for application of an activity licence is missing;
- the person receiving an activity licence does not comply with the terms and conditions of obtaining the licence;
- the person holding an activity licence does not comply with the terms and conditions of holding the licence;
- officials treat persons applying for/holding activity licences unequally;
- persons operate without activity licences.

Procurements

In the Ministry of Justice we evaluated the conduct of large-scale construction procurements in addition to the assessment of the general organisation of procurements; in the Ministry of the Environment we focused on sphere-specific procurements and on problems relating to the objects of procurements organised by Riigi Kinnisvara AS (enterprise of state's real estate): the prices of renovation of buildings and premises, and the future liabilities of state agencies relating to lease payments resulting from these prices.

The following main risks occur in the organisation of procurements:

- unnecessary things, works or services are purchased;
- the public procurement procedure established by law is not organised;
- the selection of the type of tendering procedure does not comply with the law;
- the requirements of law are not observed as regards the procurement process;
- the procurement contract is not made in accordance with the terms and conditions specified in the invitation-to-tender documents and in the successful tender;
- the purchaser fails to apply sanctions in case of the supplier's failure to abide by the terms and conditions of the contract.

***Ad hoc* audits**

In the year 2003, four *ad hoc* audits were carried out: we audited the economic activities of the Cultural Endowment of Estonia and the Compensation Fund and the granting and guaranteeing of housing loans by the Credit and Export Guarantee Agency, and assessed the risks that occur in the privatisation of state land. The audit of the Cultural Endowment of Estonia was triggered by the scandal of its managing director having stolen millions from the Cultural Endowment. The audit was carried out simultaneously with the investigation conducted by the Security Police and it ascertained the total amount of damage caused to the Cultural Endowment.



Employees of the Performance Audit Department in February 2004

Below, from the left: Jaanus Kasendi, Eili Lepik, Kairit Peterson, Krista Jansen, Heiki Randma, Märt Kivine, Jelena Zubova, Aalo Kukk, Külli Nõmm, Eva Lätti, Kristjan Paas, Janno Veskimets. Above, from the left: Lauri Tammiste, Kaire Tamm, Andra Peel, Siiri Suits, Terje Keerberg, Tuuli Rasso, Uku Mats Peedorsk.

1.3. Performance audit

“Performance audits deal with troublesome aspects of society and the functioning of the state,” one of my good colleagues stated, when explaining to the new manager of the Performance Audit Department what the department had been dealing with and how performance audits were carried out. It is true – performance audits monitor the phenomena in case of which the communication of the state with its citizens should be fruitful rather than unfulfilling, but which rarely is such.

In the year 2003, the department continued to guide itself by the principle of acting on the basis of the actual problems, not the administrative structure of the state, incl. the areas of government of ministries. Nevertheless, the selection of spheres within which the contacts of the state and its citizens are analysed changes slightly each year and that was also the case in the year 2003. By the beginning of the year 2004, four spheres had been distinguished:

- business environment;
- environmental protection;
- independent subsistence;
- health care.

Of course, these spheres are closely interconnected in one way or another: environmental protection is undoubtedly ultimately related to the business environment, just as the latter is connected with the sphere of subsistence on the level of individuals; health care is the furthest-reaching output of the social network and at the same time a form of business.

A good performance audit requires a lot of efforts. At first the most painful everyday problems, to the settlement of which the State Audit Office could contribute, must be ascertained. When compared to other types of audits, in the case of a performance audit the selection of the topic has a more significant role and therefore responsibility is already rather heavy before the commencement of the actual audit. Moreover, conducting a performance audit and making proposals are not easy either, if the problem concerns the areas of government of several ministries.

“The performance audit is art,” Eva Lähti, a Chief Auditor, admitted during the workshop of the supreme auditing institutions of the Nordic Countries and the Baltic States held at Pühajärve in autumn of 2003. The Performance Audit Department is required to master that art. And we must not be afraid of trouble, as far as it aims at reducing the troubles of citizens.



Märt Kivine
Chief Auditor

Essence of performance audit

The aim of performance audits is to evaluate the activity of the public sector in solving everyday problems, to carry out in-depth analyses of the reasons for the problems, and to suggest ideas for overcoming the problems.

The essential basis of our recommendations consists in explaining and promoting better administrative practices. According to the methodology of performance auditing, the best administrative practice is expressed in economy, efficiency and effectiveness.

Economy is the first step of the three criteria and denotes minimisation of expenses incurred in pursuing the pre-determined goals. The State Audit Office has not carried out separate audits of the aspect of economy, but treated it in conjunction with efficiency, which means that the relationship of the expenses incurred and the output delivered on the account of the expenses is explored: i.e. how is it possible to achieve more with the same resources, or how is it possible to achieve the same with less resources? When examining effectiveness, we go beyond the issue of money: we analyse the accomplishment of the goals declared in legislation and planning documents, and the actual impact of activities in comparison with that intended.

The State Audit Office is also interested in the prerequisites of efficiency and effectiveness. This means that we analyse whether in planning and implementing activities the public sector takes guidance from the good management practice and considers the actual needs of society. Moreover, performance audits often examine whether the Government has done or planned to do anything at all to solve a problem in question.

When compared to other audit types, performance auditing is the most time-consuming; it takes 6–9 months to complete a performance audit on average. Also, performance auditing generally requires comprehensive knowledge in the social sciences and economics, as well as an understanding of public administration.

Key figures of the year 2003

The following seven audits were completed and made public in the year 2003:

- The “Tiger Leap” Programme in Estonian general education schools;
- Providing prisoners with work, and AS Eesti Vanglatööstus;
- Bringing young people who have dropped out of basic schools back into the educational system;
- Activity of the state in using money in order to support entrepreneurship;
- Improving the efficiency of labour mediation in the public labour market system;
- Pre-trial procedure;
- Monitoring the demand for ambulatory specialised medical care.

The audit of organisation of non-hazardous waste handling was finished with a letter, i.e. without the audit report having been drawn up. We commenced seven audits.

Essential results of auditing

An effectiveness audit must be effective

While evaluating, inter alia, the effectiveness of public administration, a performance audit itself must be effective in order to ensure a profound discussion and implementation of the recommendations provided.

One of the audits carried out by the State Audit Office was for the first time discussed at a session of the Government. The audit discussed was that of the activity of the state in channelling money in order to support entrepreneurship. How?

Year by year, the Government allocates more and more money to commercial undertakings in the form of state aid, loans, warranties and export guarantees. What is the aim of the Government? How reasonable is the structure of allocating public funds?

Auditors sought answers to these two questions, and it was not an easy task.

Eight development plans, which were different and yet dealt with similar problems, target groups, objectives and activities, failed to clarify the precise objectives of the Government in supporting commercial undertakings. Even the principal strategy determining the allocation of public funds – the budget strategy – revealed confusion rather than clarity.

Then again, that lack of unity was easy to explain – the answer lies in the lack of coordination between four ministries (the Ministry of Economic Affairs and Communications, the Ministry of Social Affairs, the Ministry of Internal Affairs, and the Ministry of Agriculture) and the Minister of Regional Affairs. The method of drawing up the state budget is institution-based. Such an approach has encouraged and continues to encourage ministries to plan their activities separately, within their individual areas of government, as well as to justify the activities carried out in their respective areas of government.

And therefore public funds are disbursed via different structures. For example, the Credit and Export Guarantee Agency and the Rural Development Foundation disburse loans to similar target groups, yet within the areas of government of different ministries. Or take the Enterprise Estonia Foundation and the Labour Market Board: each of these agencies grants starting aid for commencing business – and also within the areas of government of different ministries.

We suggested that the objectives of supporting entrepreneurship should be defined clearly and that a uniform budget should be drawn up for that area; we also recommended specifying the areas of government of ministries and designating the ministry in charge for the cases where the areas in question coincide; analysing the reasonableness of separate structures engaged in disbursing funds, and finding possibilities for integrating their activities.

Since no such cooperation has emerged as a result of the initiative of a minister, it was decided to bring the proposals to the Government as the body that coordinates the work of ministers, and also to refer some proposals to the Ministry of Finance whose main task is to monitor the drawing up and implementation of the budgets of ministries as well as to advise the Government in economic and financial issues.

The Government shared our opinion about the nature of the problem; ministers committed to analysing the current arrangement of entrepreneurship grants and to submitting proposals for improving the same. The State Audit Office was glad to read the analysis prepared by the Ministry of Finance, which supported the conclusions of the audit and referred to the inexpediency of the current structures. We will look forward to reasonable amending resolutions in the year 2004.

Bringing problems in the open

As regards the problem-based approach, we deem the precise analyses of the functioning of state agencies and the citizens' concern about the pain spots of society as equally important factors that trigger the activity of the State Audit Office.

Children's dropping out of the societal security network is definitely the most painful challenge facing a civilised society. The State Audit Office has in several audits treated the educational system as the primary mechanism ensuring the sense of inclusion in society. In the year 2003, the issues raised by the State Audit Office crossed the news threshold in the country's leading weekly. "The State Audit Office has undoubtedly referred to a problematic area of the ministry – Estonia evidently lacks a functioning and precise student register. The shocking conclusions were already reached during the term of office of the previous minister; however, even in this academic year officials are unable to state the exact number of pupils who attend school. Moreover, they do not know how many children have been enlisted, yet do not attend school." *Eesti Ekspress* wrote this on 17 September 2003.

In 2003, we continued investigation into the problems discussed in the audit of compulsory school attendance carried out in 2002. The audit conducted in 2003 examined the problem of bringing young people who have dropped out from basic schools back into the educational system. In the audit of compulsory school attendance we concluded that approximately one thousand pupils drop out of schools each year and that the state is even not capable of keeping accurate records on the fulfilment of the obligation to attend school. We also pointed out the essential circumstance that the Ministry of Education of Research is incapable of ensuring the implementation of all established measures across the country.

In the audit of bringing people without basic education back into the educational system we focused on the young people who have already dropped out of schools. We examined what has been done in order to bring these young people back to school. The audit revealed that the state should in any case make efforts to bring people without basic education back to school, because education ensures a better ability to cope in society and reduces the hazard of young people turning to crime. In our proposals to the Minister of Education and Research we recommended expanding the possibilities of people without basic education of learning, and finding resources to support them during studies.

Performance audit is gaining strength

Since we are able to complete fewer performance audits than other audits during the same period of time, each individual performance audit gains significant weight. It has been pleasant to acknowledge that all the other audits carried out in the previous year had their memorable aspects, as well. For example, in the audit of pre-trial procedure we managed to not just highlight the need and possibility to improve processes, but also to point out a particular amount of money that could be saved by implementing the recommendations of the State Audit Office. The audit that dealt with queues to doctors initiated a discussion of a wide range of problems relating to health care services and, being a part of the subsequent related audits, will hopefully contribute to the development of customer-friendly servicing and improvement of the availability of services in the health care system.

Our auditors' sphere-based competence that accumulates year-by-year provides good prerequisites for discussing complex problems and for making competent proposals.



2. The SAO as a participant in public administration

In addition to auditing, the State Audit Office is actively participating in the development of public administration – in particular the control environment thereof – both on the national and international levels. Besides the right of the Auditor General to participate with the right to speak in the sessions of the Government of the Republic, the law provides the State Audit Office with the following rights and duties in addition to these relating to auditing:

- to make proposals for the preparation and amendment of legislation;
- cooperate with the Government of the Republic in order to improve the internal control and internal audit of government agencies and state agencies administered by government agencies;
- communicate with the supreme audit institutions of foreign states, participate in the activities of the international organisations of such institutions and cooperate with the European Court of Auditors.

Participation of the State Audit Office in public administration is restricted by its independence. The State Audit Office does not interfere with politics or assess political goals.

In Estonia

The State Audit Office participates in the preparation of legislation in several ways. By presenting opinions on draft legislation, action plans, etc., discussed in the sessions of the Government, the Auditor General forwards our positions directly to the Government. We also participate in the early stages of processing draft legislation. In the year 2003, our principal contribution to the development of legislation concerned the preparation of the State Budget Act, the Accounting Act, the State Audit Office Act, the Rural Municipality and City Budgets Act, and the Use of Privatisation Proceeds Act Amendment Act. The following important changes will apply to us as a result of the new legislation:

- Formation of the select committee of the Parliament for supervision over the state budget (incl. for discussing the results of audits carried out by the State Audit Office);
- When rendering opinions on the correctness of the annual accounts of state agencies and on the legality of transactions performed by state agencies, the State Audit Office must be able to rely on the work of internal auditors of these institutions.

The volume of the legislation and the Government's action plans in respect whereof the State Audit Office provides its opinion is growing on an annual basis, demonstrating an increase in the significance of the State Audit Office as a participant in public administration. To ensure that our role would evoke a more influential and comprehensive response, we need active and strong partners. We see the Parliament's Select Committee on the Control of the State Budget as an important partner who will contribute to the materialisation of our proposals.



Employees of the Services of the State Audit Office in February 2004

Below, from the left: Markko-Raul Esop, Peeter Annus, Kristjan Mellik, Rein Söörd, Ingrid Lepasild, Jaana Tõnisson, Peeter Lätti, Piret Malv, Airi Alakivi, Timo Tupp, Kalev Lattik, Sven Soiver.

Above, from the left: Hedy Kohv, Ene Viru, Katrin Gottlob, Ira Tambik, Katri Kadakas, Sander Türk.

In order to be able to rely on the work of the internal auditors of state agencies, we will continue to concentrate on the development of the internal audit system in conjunction with the Government and the Ministry of Finance. To that end, in the year 2003 Kaie Karniol, Siiri Matverk, Jüri Kurss and Ines Metsalu of the State Audit Office participated actively in the working group operating at the Ministry of Finance with the aim of developing a budget implementation supervision model.

The State Audit Office has always supported sound and innovative initiatives of the public sector. The National Electoral Committee, to which Peeter Lätti, the Director of the State Audit Office, also belongs, commenced preparations for e-elections. Airi Alakivi, the Personnel Manager, belongs in a working group for training officials, the objective of which is to coordinate the training priorities of the public sector and to develop the civil service that complies with the requirements of the European Union.

Kaie Karniol and Tõnis Saar, an adviser to the State Audit Office, participated in the working group for reorganisation of public accounting headed by the Ministry of Finance, whose work resulted in the General Rules of Public Accounting at the end of the year 2003. Employees of the Performance Audit Department participated as assessors in the Public Sector Quality Prize project.

International cooperation

Strengthening of the position of the State Audit Office in the international auditing environment enables us to participate more in cooperation projects both as experts and partners. We gain experience of good auditing practices and share our knowledge and experience with others.

Close cooperation with the European Court of Auditors and European supreme auditing institutions contributes to the attainment of the audit quality that conforms to the level recognised in Europe. Also in the year 2003 we participated in the regular meetings of the supreme auditing institutions of countries of Central and Eastern Europe, Cyprus, Malta and Turkey and managers of the European Court of Auditors, where recommendations concerning institutional development and the development of audit activities and methodology are adopted.

The State Audit Office also continued to participate in the work of the European Organisation of Supreme Audit Institutions (EUROSAI) and the International Organisation of Supreme Audit Institutions (INTOSAI).

Our employees participated in the following working groups and projects:

- The INTOSAI working group on the audit of privatisation, environmental auditing, and audit standards committee;
- The EUROSAI working group on environmental auditing, and IT auditing;
- The working group on audit manuals formed on the basis of the supreme audit institutions of the EU candidate countries and the European Court of Auditors;
- The project of auditing the Ukrainian public sector, funded out of the TACIS programme.

In June, a cooperation programme which had lasted for three and a half years and involved the State Audit Office, the Court of Auditors of the Netherlands and the MDF management consultation company was completed with a summary conference. In the course of the cooperation programme the principles of work and organisation of the State Audit Office were thoroughly reformed; more than 10 audits were carried out in conjunction with the experts of the Court of Auditors of the Netherlands.

In 2003, the State Audit Office had the task of organising the annual meeting of representatives of the supreme audit institutions of the Baltic States and Nordic countries. At the conference held in September issues relating to the auditing of state revenues and the planning of performance audits were discussed; participants in the “good audit” working group shared their most useful experiences collected in the course of audits.

Courses of action in the year 2004

One of the primary goals for the year 2004 is to help the Parliament's Select Committee on the Control of the State Budget to develop an efficient and reciprocally functional routine of work.

As control over local governments has been relatively weak and inconsistent to date, efforts have been made to amend the State Audit Office Act such as to establish the tasks and competence of the State Audit Office in auditing the use of money by local governments more clearly. Thereby the State Audit Office hopes to materially improve the efficiency of external auditing of the use of money by the public sector.

As regards the international level, work in the contact committee of the supreme audit institutions of the European Union and the European Court of Auditors should be deemed the most important. Participation in the preparation of the "EU Trend Report" is one of our key projects. The project was prompted by the ambitious plan to provide an overview of the trends of using and managing funds of the EU, and the respective reporting and auditing in as many European countries as possible. The project is headed by the Court of Auditors of the Netherlands and it involves the supreme audit institutions of Denmark, Sweden, the United Kingdom, Spain, Poland and other countries.



The closing conference of the cooperation programme of the State Audit Office, the Court of Auditors of the Netherlands and the MDF management consultation company held in Tallinn on June 13, 2003.



3. Extension of the audit activities

3.1. Audits of local governments

The purpose of local governments is to bring the management of local affairs nearer to the people and to enable people to arrange their lives by themselves, whereas it is obvious that in many spheres people are able to do it more precisely, diligently and efficiently than the central government.

However, the existence of rights inevitably entails control over the exercise of the rights – for example, for the reason that the money on the account of which the rights are exercised is obtained from taxpayers. Since the position of the State Audit Office is that the public sector must not contain uncontrolled areas, our sphere of interest includes local governments, as well.

Owing to the audit-related and organisational changes introduced in the State Audit Office in recent years, we have confined ourselves to audits of state aid allocated to local governments.

In the year 2004, the State Audit Office intends to carry out more comprehensive audits of the activities of local governments. Therefore, we will continue auditing the grants of state aid and additionally carry out a so-called in-depth audit in one local government. This means that in the course of auditing the use of a state aid we will not examine just the use of funds allocated from the state budget in connection with that particular aid, but assess the activity of the local government in using all state budget assignments. The aim of such an approach is, inter alia, to map the potential risks for the purposes of similar future audits.

Although the State Audit Office plans to increase the number of audits relating to local governments, this will not be enough to create a functioning control environment. Therefore, we have developed our positions regarding the improvement of the control system of local governments, the implementation of which should increase the reliability, transparency and efficiency of local governments and to ensure the legality of their economic activities. The following are some of the essential proposals:

- Extension of the scope of mandatory auditing.

The legislator should extend the scope of auditing of local governments such that besides the annual report an audit would also encompass the organisation of internal auditing and the legality of transactions of the local government in question. In the opinion of the State Audit Office, another problem lies in the circumstance that according to the Accounting Act, auditing of annual reports is not mandatory for all local governments. According to the Ministry of Finance, 12% of local governments remained unaudited in that respect.

- Introduction of internal control and internal audit.

The Local Government Organisation Act does not determine the obligations of city governments and rural municipality governments in organising internal control and internal auditing. In the opinion of the State Audit Office, legislation should prescribe the obligation of local governments to create a functioning internal control system and – in case of a large local government – to form an internal audit unit.

- More precise specification of the role of the auditing commissions of rural municipality and city councils.

In the opinion of the State Audit Office, the circumstance that the majority of the auditing commission often consists of the representative of the coalition inhibits the efficiency of auditing commissions. Such practice may entail conflicts between the duties of the commission and the actual work. Therefore, the position of the State Audit Office is that representatives of the opposition should be in charge of auditing commissions.

3.2. Audits of the use of EU funds

The referendum held in 2003 opened Estonia's way to the European Union. Although things will not change overnight, the integration process will entail several changes for the State Audit Office.

The central change will consist in the movement of large flows of funds between the European Union and Estonia – in both directions.

The State Audit Office has treated the EU funds as equal to the budgetary funds of Estonia and planned the audits of using these funds on the basis of the same criteria and risk assessments. The State Audit Office is competent to decide on the scopes of auditing the use of EU funds and the budgetary funds of Estonia. Funds envisaged for the public sector must be used rationally and lawfully, irrespective of their origin.

Although the proportion of the EU funds is relatively small in the context of state budget costs, it is still quite considerable in some spheres. This means that in terms of the criteria of selection of audits (incl. the amount of funds circulating in the sphere), a certain change will occur in audit topics, i.e. more attention will be paid to the use of funds originating from the European Union.



Meeting of the supreme audit institutions of the Baltic States and Nordic countries at Pühajärve, held on September 3–5, 2003.

From the left: Aivar Nigol, Rural Municipality Mayor of Otepää; Maarten B. Engwirda, representative of the European Court of Auditors; Märt Kivine, Head of the Public Relations Service of the State Audit Office; Mihkel Oviir, the Auditor General; Jonas Liaučius, the Auditor General of Lithuania; and Raits Černajs, the Auditor General of Latvia.

The entire workload will not fall on the State Audit Office of Estonia, though: the European Court of Auditors as the auditor of the European Union is also entitled to carry out audits of the use of funds allocated from the budget of the EU. The European Court of Auditors is obviously interested in the strength of the State Audit Office of Estonia – from the point of view of the European Court of Auditors the State Audit Office of Estonia is an internal control unit on whose work the European Court of Auditors can rely in its work.

The European Court of Auditors will inform us of its audit plan and provide regular preliminary information about audits concerning Estonia. Thus the duplication of the work of the State Audit Office and the European Court of Auditors will be avoided. Preclusion of duplication entails the efficiency of audit activities.

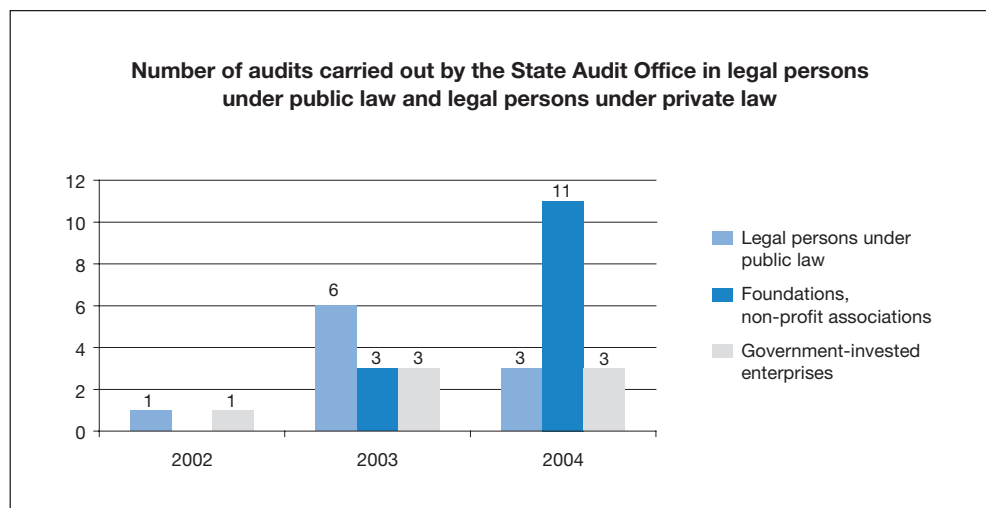
Accession to the European Union will add one more dimension to the duties of the State Audit Office. While we have audited the receipt of tax revenues in Estonia for several years, after the accession we will also have to audit the correctness of accounting and transfer of sums to be transferred to the budget of the European Union. In this regard the duty of the State Audit Office is to provide an overview of whether the accounting systems involved with the payment and accounting of these sums function such as to ensure that our obligations to the union are fully met.

Besides audit activities, exchange of information and experience with the European Court of Auditors will be significant, as well. At the end of February, Eva Lätti, a senior auditor of the Performance Audit Department, completed her 5-year practice at the European Court of Auditors. Maarten B. Engwirda, a member of the European Court of Auditors, delivered a speech at the closing conference of the cooperation project of the State Audit Office and our partners from the Netherlands in June, and at the meeting of the representatives of the supreme audit institutions of the Baltic States and Nordic countries at Pühajärve in September.

3.3. Audits of legal persons under public law, foundations established by the state, and government-invested enterprises

The State Audit Office Act that was effective until March 2002 provided for our competence to audit legal persons under public law and private law in a sketchy and inconsistent manner. As regards our competence to audit legal persons under public law, legislation provided differently: while in case of some of the legal persons we were entitled to audit all of their economic activities, with others we could just audit the use of resources assigned to them from the state budget. The State Audit Office Act did not provide for audits of foundations. However, the Articles of Association of some foundations prescribe that the use of resources assigned to the foundations from the state budget should be audited by the State Audit Office.

The State Audit Office Act that entered into force on 4 March 2002 establishes the auditing competence of the State Audit Office as follows: in addition state agencies, the State Audit Office shall audit also legal persons under public law; foundations founded by the state or a legal person under public law; companies where the state or legal persons in public law jointly or separately exercise a dominant influence through a majority holding or in any other manner, and the subsidiaries of such companies.



There are a total of 21 legal persons under public law in Estonia. At the end of last year, the state held through ministries, county governments and constitutional institutions founder's rights in 60 foundations, which were either operating, in liquidation or still in foundation. The state was the sole founder of 38 operating foundations. The state had a holding in a total of 51 operating companies – a 100% holding in 35 companies, and a holding of less than 50% in 11 companies.

In connection with the specification of the competence of the State Audit Office and the serious offences committed in some legal persons (first of all the Traffic Insurance Fund and the Cultural Endowment of Estonia), we have in recent years paid more attention to the assessment of risks occurring in the activities of these persons and to conducting corresponding audits.

When assessing risks inherent in the public sector in the course of drawing up the work plan of the State Audit Office, it appeared that although in the case of government-invested enterprises, legal persons under public law and foundations founded by the state, audits have been commissioned from private auditors, such audits are not sufficient, because they fail to provide an overview of the legality of transactions, reliability of management and the sustainability of legal persons, or point out the reasons for loss. This is not a reproach directed towards private auditors – an ordinary auditor's report on annual accounts is not supposed to discuss management. Then again, extension of the scope of audits is in the competence of the persons commissioning audits – the ministries. These persons have not regarded such an extension of the audit scope as necessary, though. Audits carried out by the State Audit Office in the Estonian Agricultural University and in the Defence League clearly revealed that although annual accounts may be correct, this does not assure reasonable financial management.

Unless the legislation stipulates a requirement on the extension of the scope of audits in the public sector and the persons commissioning audits deem such an extension necessary, the State Audit Office has to deal with these problems. Hence, in our audits we have either examined the economic activities of a legal person as a whole or concentrated on an essential field of activity. The following are some examples of audits carried out:

- The State Audit Office assessed the termination of activities of the Compensation Fund, focusing on whether the receivables of the Fund and the investments of subsidiaries had been sold in a lawful and economically purposeful manner and whether the assignment of monies in the course of the termination process had been in compliance with the Compensation Fund Act. It appeared that although the Compensation Fund Act permitted the money remaining to be transferred after the termination of activities only into the stabilisation reserve, deposits to the amount of 45 million kroons had been transferred to the Credit and Export Guarantee Agency and the Enterprise Estonia Foundation through the Ministry of Economic Affairs and Communications under the orders of the Government. Moreover, under an order of the Government the Compensation Fund had acquired fund units in the Hansa Money Market Fund for 82 million kroons and delivered the fund units to the Ministry of Finance. In the opinion of the State Audit Office, the Government had violated the law when issuing these orders.
- As regards Riigi Kinnisvara AS (enterprise of state's real estate), we audited the organisation of public procurements. We found that the activity of the company relating to procurements is relatively well-organised. Internal regulations have been drawn up with regard to conducting procurements; the key issues of all procurements are established by the resolutions of the management board. The procurement procedure was commenced in all the prescribed cases. We detected violations in case of two procurements: in one case the invitation-to-tender documents contained unreasonable requirements; in the other case after the failure of the procurement of furniture the organisation of a new procurement was trusted with a construction company who was not required to abide by the requirements established in the Public Procurements Act. As we had also observed such incidents earlier, a proposal was forwarded to the Minister of Finance for making the Public Procurements Act concrete. By now, the Public Procurements Act has been amended, and things and services which are not directly necessary for the construction work in question must be purchased separately.

We also analysed the principles of determining the amounts of rentals payable by state agencies and suggested to the Minister of Finance that the calculations of these amounts be based on expenditure categories. Also, a position should be adopted with regard to the profit margin applied by the commercial undertaking to state agencies. We also proposed that expenditure norms be established for state agencies and that the increase in rental costs be evaluated and more stringent restrictions be established for state agencies in that regard. The Minister of Finance regarded our proposals as justified.

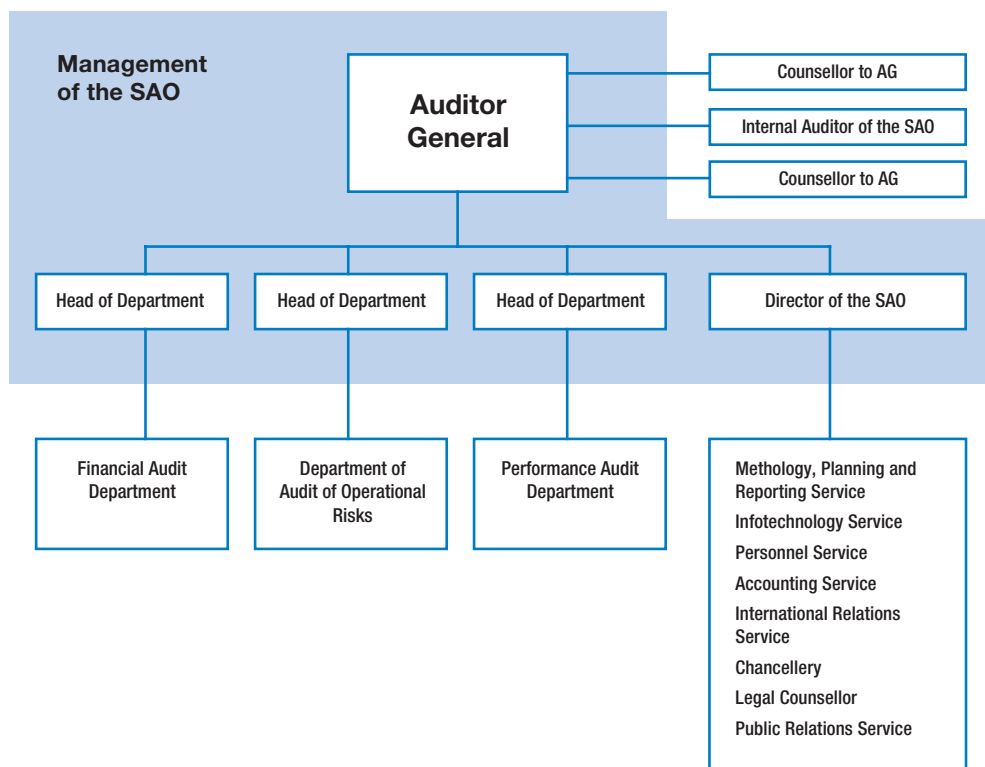
- When auditing the economic activities of the Estonian Agricultural University, the State Audit Office concluded that management of the economic activities of the university is characterised by major shortcomings, incl. the following:
 - No late payment interest was collected from the more than 600 students who had failed to pay the tuition fee of total approximately 5 million kroons. Nor were debts to the approximate amount of one million kroons collected from the students who had been admitted from paid-for study to study financed out of the state budget, or who had left the university.

- Upon sales of real properties, the university had frequently permitted the buyers to pay for the purchase on an instalment plan, thus assuming financial risks. It appeared in the course of the audit that several buyers were indeed in financial difficulties. The State Audit Office deems hire-purchase sales (which basically means lending) unreasonable, because a solvent buyer can always apply for a bank loan.
- The university had approximately 44 million kroons in the bank, of which 32 million had been invested with a yield of 3%. At the same time, the university had assumed loans to the total amount of approximately 44 million kroons, whereas the loan interest ranged from 4% to 10%. Hence, interest expenses exceeded interest income. Costs could be saved if the loans were repaid with the existing money, because, e.g. in 2002 the university's interest income exceeded interest expenses by 1.2 million kroons.
- It also appeared that more students have repeatedly been admitted than practicable in the opinion of the board of the university. The most obvious infringement occurred in the department of accounting and financial management, where the board had envisaged up to 45 student places, but actually 53 students were admitted to full-time study and 68 students were admitted in the form of distance learning. In this way the university is able to earn more revenue, but the quality of education is jeopardised.



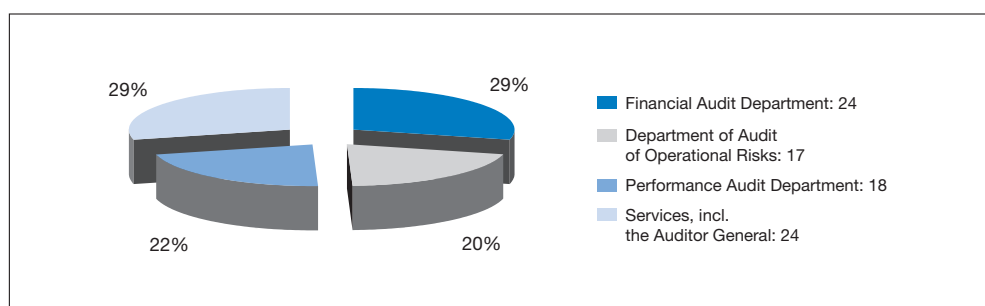
4. Organisation

4.1. Structure of the SAO



4.2. Composition of staff

The strategy of the State Audit Office for the year 2003 prescribed 92 positions within the staff. At the end of the year, nine positions were vacant. The 83 employees were divided across departments as follows:



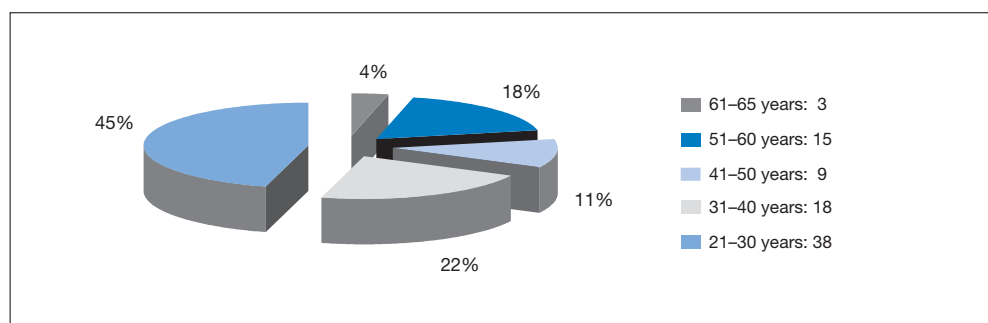
During the year, thirteen new employees commenced work in the State Audit Office; eleven of them had been employed as a result of a public competition. Eighteen employees resigned from office; ten of them continue working in public service, four left to the private sector, three commenced studies, and one retired on pension. As a result of internal competitions and development interviews held in accordance with the personnel policy of the State Audit Office, nineteen employees were promoted. Six students contributed to the work of the State Audit Office in the course of their apprenticeship.

4.3. Education, age, length of service and gender-based distribution of employees

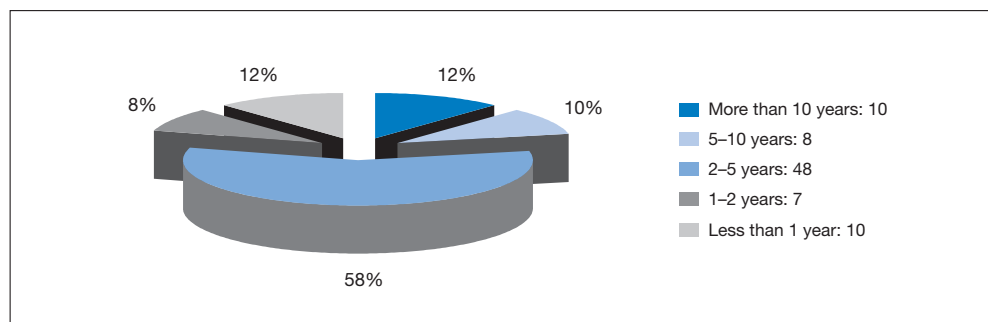
90% of the employees of the State Audit Office have higher education. When looking separately at audit departments, the proportion of employees with higher education is even higher – 97%. 9% of the employees have a master's degree and 23%, i.e. 19 employees are acquiring it.

The average age of employees as of the end of the year was 36.5 years.

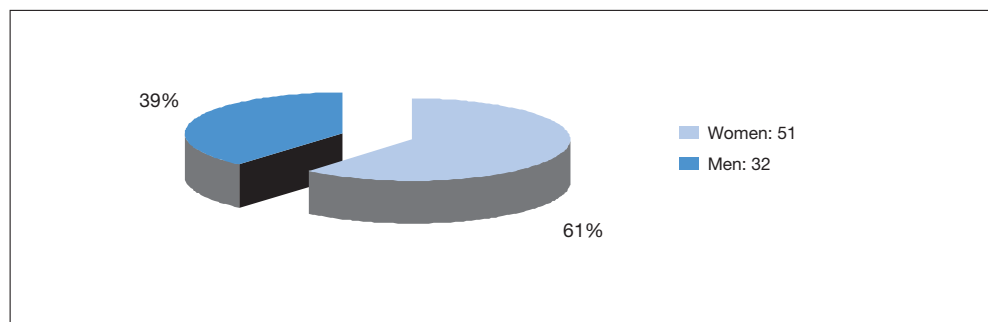
By age groups the employees were distributed as follows:



At the end of the year, the average length of service of the employees in the State Audit Office was four years. Across the length of service the employees were distributed as follows:



The distribution of employees by gender reveals that women outnumber men.





5. Economic activities

5.1. Use of funds allocated to the SAO

Budget

The operating expenses of the State Audit Office are covered from the state budget. The state budget for the year 2003 allocated 32,004,000 kroons to the State Audit Office, of which 113,362 kroons remained unused. The expenditure budget of the State Audit Office made up nearly 0.1 % of the total expenses of the state budget.

The budget allocated for the year 2003 increased by 13.5%, i.e. 3.8 million kroons when compared to the budget for the year 2002. The significant growth of the budget was due to the cost of renovation work scheduled for the years 2003–2004.

| Article | Budget | Cash expenditures |
|--|-------------------|-------------------|
| Staff costs | 21,477,522 | 21,477,521 |
| Administrative expenses | 7,290,478 | 7,286,446 |
| Membership fees | 16,000 | 13,310 |
| Acquisition and renovation of tangible and intangible assets | 3,022,000 | 2,915,516 |
| Acquisition of IT equipment and computer technology | 911,000 | 857,617 |
| Acquisition of software | 105,000 | 89,600 |
| Acquisition of non-depreciable assets | 6000 | 5988 |
| Renovation of buildings and structures | 2,000,000 | 1,962,311 |
| Interest expense on financial lease | 21,000 | 20,845 |
| Financial lease payments | 177,000 | 177,000 |
| Total | 32,004,000 | 31,890,638 |

A total of 307,696 kroons was incurred in connection with the settlement of student loans under the Education Act. The required sum was allocated to the State Audit Office separately under the application submitted to the Ministry of Finance.

Statement of financial position

| | 31.12.2003 | 31.12.2002 |
|---|-------------------|-------------------|
| Assets | | |
| Current assets | 101,604 | 119,078 |
| Non-current assets | 22,448,490 | 22,919,629 |
| Total assets | 22,550,094 | 23,038,707 |
| Liabilities and net assets | | |
| Current liabilities | 1,038,321 | 1,138,574 |
| Non-current liabilities | 0 | 95,333 |
| Net assets | 21,511,773 | 21,804,800 |
| Total liabilities and net assets | 22,550,094 | 23,038,707 |

Assets

Prepayments in the amount of 101,604 kroons have been reported as current assets. Expenses prepaid for the year 2004 account for the major part of that amount. The prepaid expenses include periodicals in the amount of 79,875 kroons and insurance costs in the amount of 10,251 kroons.

As of 31 December 2003, the net book value of non-current assets of the State Audit Office amounted to 22,448,490 kroons, incl. tangible assets in the amount of 22,291,729 kroons and intangible assets in the amount of 156,761 kroons.

Tangible assets include the office building at Narva mnt 11 in Tallinn and other assets with long-term useful lives, the cost of which is equal to or exceeds 10,000 kroons. Software with the acquisition cost of 10,000 kroons or more has been recorded as an intangible assets.

During the year, 2,921,613 kroons were invested in non-current assets. Investments in information technology and renovation projects were the major investments. In order to maintain the required level of information technology, 15 personal computers and 12 laptop computers were replaced (for a total of 445,800 kroons). Renovation of the ventilation system was started (the cost of the first stage amounts to 1,918,798 kroons).

Low-value items, the cost of which is less than 10,000 kroons, which are expensed upon acquisition and which are accounted for off-balance sheet, were recorded in the value of 1,544,988 kroons as of 31 December.

Liabilities and net assets

Current liabilities comprise holiday pay related liabilities in the amount of 822,521 kroons, payables to suppliers for deliveries made in December in the amount of 80,731 kroons, and tax liabilities on the payments made in December in the amount of 39,053 kroons. Capital lease payments to AS Hansa Liising under the contract made in 2000 for the purchase of office furniture amount to 95,333 kroons.

The sum of capital and the retained net surplus/deficit for the year 2003 and previous years make up the net assets.

Statement of financial performance

The cash-basis revenues of the State Audit Office for the year 2003 amounted to 32,198,334 kroons. Accrued operating expenses amounted to 29,121,353 kroons, depreciation of non-current assets amounted to 3,076,112 kroons and financial expenses (financial lease interest) amounted to 21,860 kroons.

| | 2003 | 2002 |
|---|--------------------|-------------------|
| Operating revenue | | |
| Revenue from state budget | 32,198,334 | 27,962,829 |
| Total operating revenue | 322,198,334 | 27,962,829 |
| Operating expenses | | |
| Salaries and wages | 15,703,838 | 14,707,909 |
| Social tax expenses | 5,261,010 | 5,096,209 |
| Outstanding holiday pay | 81,497 | 131,421 |
| Other staff costs | 1,856,154 | 1,258,790 |
| Administrative expenses | 6,201,730 | 5,176,238 |
| Other operating expenses | 3814 | 127,341 |
| Membership fees | 13,310 | 10,309 |
| Total operating expenses | 29,121,353 | 26,508,217 |
| Depreciation of non-current assets | 3,076,112 | 2,899,205 |
| Financial income and expenses | -21,860 | -59,299 |
| Net deficit | -20,991 | -1,503,892 |

Operating expenses

The largest expenditure items of the budget of the State Audit Office – salaries and wages of employees and the social tax and unemployment insurance tax assessed thereon (summarised in the table under *social tax*) accounted for 72% of the operating expenses for the year 2003 (20,964,848 kroons).

The salaries and wages of employees comprise salaries, additional remuneration payable for years of service, academic degrees and maintaining state secrets, and competency pay, bonuses and allowances payable under the evaluation and incentive system of the State Audit Office.

On average, the salaries made up 75% of all the wages and remuneration paid. In 2003, the average monthly salary of the Auditor General was 49,077 kroons, of which 38,063 kroons was the salary and 11,014 kroons was additional remuneration. The average monthly salary of other strategic managers, i.e. Chief Auditors and the Director amounted to 30,811 kroons, incl. salary in the amount of 22,000 kroons and additional remuneration in the amount of 8,811 kroons. The average monthly salary of medium-level managers (Deputy Chief Auditor, Audit Managers, Heads of Services) amounted to 19,354 kroons, incl. salary in the amount of 13,826 kroons and additional remuneration in the amount of 5,528 kroons. The average monthly salary of specialists (Senior Auditors, Auditors, Junior Auditors and Specialists of Services) amounted to 13,918 kroons, incl. salary in the amount of 10,512 kroons and additional remuneration in the amount of 3,406 kroons.

A total of 819,158 kroons were spent on employees' assignments in Estonia and abroad. During the year, employees were on 30 assignments abroad and on 121 assignments in Estonia. The State Audit Office invested 764,181 kroons, i.e. 4% of the annual budget of salaries and wages in the development of employees.

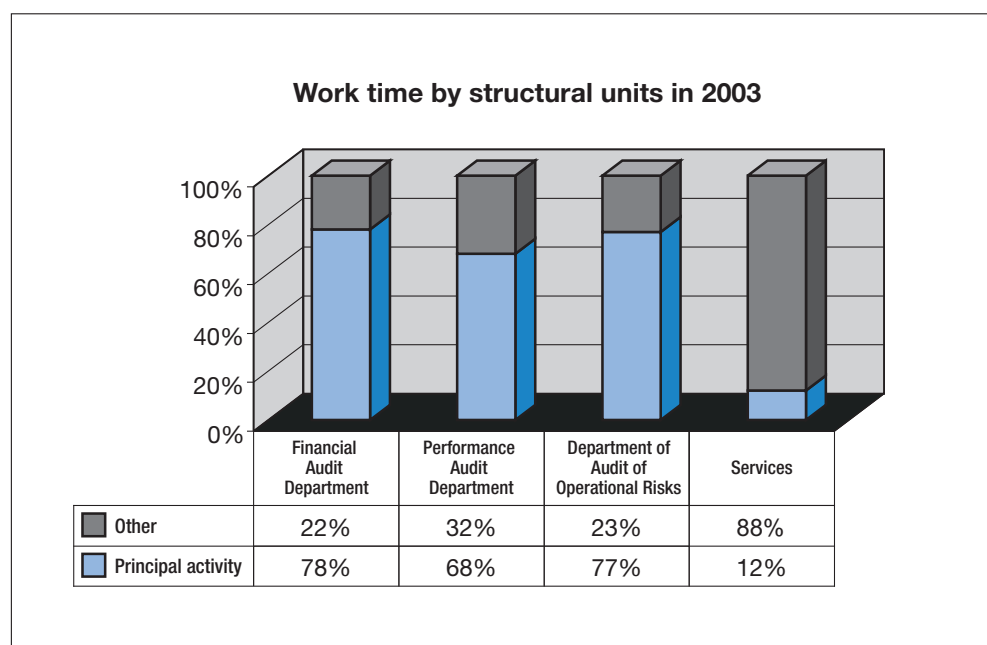
When compared to the previous year, administrative expenses increased significantly due to the renovation of the ventilation system, which was accompanied by additional cleaning and repair operations. Administrative expenses also include costs incurred in connection with social studies and market surveys, access to information channels, representational gifts, and publications introducing the activities of the State Audit Office (the annual report on the use and preservation of state assets; the closing publication of the cooperation programme carried out in conjunction with auditors from the Netherlands; a gift book, N. Gogol's "The Inspector General"; the history in pictures compiled in connection with the 85th anniversary).

Other operating expenses include the depreciated cost of non-current assets written down.

The State Audit Office paid membership fees to the European Organisation of Supreme Audit Institutions (EUROSAI) and the International Organisation of Supreme Audit Institutions (INTOSAI).

5.2. Use of work time

Since time and money are directly interrelated, the State Audit Office has for several years monitored the use of work time by the employees. Across the entire institution, 59% of employees' work time was spent directly on the primary activity, i.e. auditing and on monitoring the fields audited and participation in public administration. That indicator was 74% in the audit department on average. The rest of the time was spent on training, management and activities supporting the primary processes of the State Audit Office.



5.3. Auditor's report



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AUDITOR'S REPORT

(Translation of the Estonian original)

To the Parliament of Estonia

We have audited the financial statements of Riigikontroll (the Institution) for the year ended 31 December 2003, from which the summarised financial statements set out on pages 36 to 38 were derived. We conducted our audit in accordance with International Standards on Auditing.

In our report dated 12 March 2004 we expressed an opinion that the financial statements, from which the summarised financial statements were derived, give a true and fair view of the financial position of the Institution in accordance with the decree No 106 "Preparation, presentation and authorization of 2003 annual report", issued by the Minister of Finance of Estonia on 16 December 2003.

In our opinion, the accompanying summarised financial statements are consistent, in all material respects with the financial statements from which they were derived.

For a better understanding of the Institution's financial position and the results of its operations for the period and of the scope of our audit, the summarised financial statements should be read in conjunction with the financial statements from which the summarised financial statements were derived and our auditor's report thereon.

A handwritten signature in blue ink, appearing to read 'U. Kaarlep'.

Urmas Kaarlep
AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Maris Vask'.

Maris Vask
Authorised auditor

12 March 2004



6. Audits carried out in the year 2003

The audits carried out in the year 2003 were distributed between ministries and their areas of government as follows:

Ministry of Agriculture

1. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Agriculture for the year 2002
2. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Agricultural Registers and Information Board for the year 2002
3. Payment of the school milk allowance
4. Payment of environmental support
5. Applied research commissioned by the Ministry of Agriculture

Ministry of Culture

6. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Culture for the year 2002
7. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Vanemuine Theatre for the year 2002
8. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Art Museum of Estonia for the year 2002
9. Economic activities of the Cultural Endowment of Estonia
10. Use of fitness sports allowances

Ministry of Defence

11. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Defence for the year 2002
12. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Military Academy for the year 2002
13. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Logistics Centre of the Defence Forces for the year 2002
14. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the General Staff of the Defence Forces for the year 2002
15. Opinion of the State Audit Office on the annual accounts of the Baltic Defence College for the year 2002
16. Organisation of accounting and pertinent reporting and supervision in the Defence League in 2001–2002

Ministry of Economic Affairs and Communications

17. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Economic Affairs for the year 2002

18. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Transport and Communications for the year 2002
19. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Motor Vehicle Registration Centre Estonia for the year 2002
20. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Maritime Administration for the year 2002
21. Activity licences for road transport
22. Activity licences for imports and sales of liquid fuels
23. Granting and guaranteeing housing loans by the Credit and Export Guarantee Agency
24. Use of the aid award allocated to Elektriraudtee AS for passenger transport (follow-up audit)

Ministry of Education and Research

25. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Education and Research for the year 2002
26. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Accounting Bureau of the Ministry of Education and Research for the year 2002
27. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Tallinn Centre of Industrial Education for the year 2002
28. Organisation of accounting in the Estonian Agricultural University in the year 2002
29. Compensation for students' travelling expenses from the state budget
30. Camps organised for youth and financial support thereto
31. Issuance of education licences to basic schools and upper secondary schools
32. Issuance of work-related and informal education licences to adult education institutions
33. Targeted financing of research and development
34. Bringing young people who have dropped out of basic schools back into the educational system
35. The "Tiger Leap" Programme in Estonian general education schools

Ministry of the Environment

36. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of the Environment for the year 2002
37. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Information and Technical Centre of the Ministry of the Environment for the year 2002
38. Organisation of public procurements at the Ministry of the Environment

Ministry of Finance

- 39. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Finance for the year 2002
- 40. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Tax Board for 2002 and the report on the receipt of state revenues for 2002
- 41. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Customs Board for 2002 and the report on the receipt of state revenues for 2002
- 42. Opinion of the State Audit Office on the report on the existence and allocation of the resources administrated by the State Treasury for the year 2002
- 43. Activity of the State Treasury in administrating the cash flow of the state in the year 2002
- 44. Privatisation of state land by payment in instalments
- 45. Economic activities of the Compensation Fund

Ministry of Foreign Affairs

- 46. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Foreign Affairs for the year 2002

Ministry of Internal Affairs

- 47. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Internal Affairs for the year 2002
- 48. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Citizenship and Migration Board for the year 2002
- 49. Organisation of accounting in agencies governed by the Border Guard Administration (the Border Guard Administration, the Northern Border Guard Region, the Eastern Viru Border Guard Region and the Border Guard Patrol Boats Division) in the year 2002
- 50. Organisation of accounting in agencies governed by the Police Board (the Police Board and the Narva, Viljandi and Võru Prefectures) in the year 2002

Ministry of Justice

- 51. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Justice for the year 2002
- 52. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ämari Prison for the year 2002
- 53. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Tallinn City Court for the year 2002

- 54. Organisation of construction procurements in the area of government of the Ministry of Justice
- 55. Providing prisoners with work, and AS Vanglatööstus

Ministry of Social Affairs

- 56. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Ministry of Social Affairs for the year 2002
- 57. Opinion of the State Audit Office on the report of the receipt and utilisation of resources allocated for state health insurance for 2002
- 58. Opinion of the State Audit Office on the report of the receipt and utilisation of resources allocated for state pension insurance for 2002
- 59. Payment of state unemployment benefits
- 60. Payment of additional holiday pays from the state budget
- 61. Use of funds allocated from the state budget to the Estonian Qualification Authority
- 62. Use of funds allocated for training the unemployed and for scholarships
- 63. Payment of caregiver's allowances
- 64. Payment of rehabilitation allowances
- 65. Activity of the internal auditors of the Estonian Health Insurance Fund in assessing the payment of benefits for temporary incapacity for work
- 66. Health Care Project 2015
- 67. Improving the efficiency of labour mediation in the public labour market system
- 68. Monitoring the demand for ambulatory specialised medical care

In addition to the above list, the State Audit Office carried out audits encompassing the areas of government of several ministries:

- 69. Activity of the state in channelling funds for supporting entrepreneurship (the Ministry of Economic Affairs and Communications; the Ministry of Agriculture, the Ministry of Finance; the Ministry of Internal Affairs, the Ministry of Social Affairs and the Minister of Regional Affairs)
- 70. Pre-trial procedure (the Ministry of Justice and the Ministry of Internal Affairs)

The following audits were carried out beyond the areas of government of ministries:

- 71. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the State Chancellery for the year 2002
- 72. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Chancellery of the Parliament for the year 2002
- 73. Opinion of the State Audit Office on the annual accounts and the report on the implementation of the state budget of the Harju County Government for the year 2002





RIIGIKONTROLL

Annual Report 2003

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