Accuracy of Annual Accounts 2018 and regularity of transactions of the state

Report of the National Audit Office to the Riigikogu, Tallinn, 29 August 2019

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Summary of audit results

What did we audit?

The State Budget Act requires the NAO to audit the accuracy of the annual accounts and the regularity of transactions of the state on an annual basis. The annual accounts of the state consolidate the financial statements of all state accounting entities, state-controlled companies, state-established foundations, and the profit-making state agency.

To provide an opinion on the accuracy of the annual accounts of the state and the legality of its transactions, the NAO examined the compliance of economic transactions conducted by state authorities in 2018 with the State Budget Acts, and determined whether such transactions have been correctly recognised in their accounts.

The NAO examined whether the state's annual accounts provide true information about the state's financial position and performance for the year ended and whether state agencies have adhered to budget acts while performing their economic transactions.

This report further includes an overview of internal controls put in place to prevent corruption accompanied by relevant recommendations from the NAO.

What was the scope of our audit?

The annual accounts of the state contain the financial indicators of public undertakings, foundations controlled by the state and profit-making state agency. The annual accounts of companies, foundations and the profit-making state agency were audited by audit firms. The NAO considered the reports of certified auditors when expressing its opinion of the annual accounts of the state.

The NAO did not carry out audit procedures to check the additional information about local authorities, the public sector and the government sector disclosed in the Consolidated Annual Report of the State because, according to the State Budget Act, this is not the NAO's duty.

Why is this important for taxpayers?

The Consolidated Annual Report of the State endorsed by the Government of the Republic, accompanied by the NAO's audit report concerning it, is submitted to the Riigikogu for approval. The consolidated annual report of the state is the only financial statement provided to the Riigikogu - the user of the report.

According to the Accounting Act, the purpose of submitting the annual accounts of the state is to allow the Riigikogu to exercise control over the government and give the government the opportunity to explain its activities undertaken during the accounting year.

By auditing the state's annual accounts the NAO provides assurance that the accounting indicators presented to the Riigikogu and the public provide true information about the state's financial position and performance for the year ended and that the State Budget Implementation Report includes relevant information about the state's revenue as well as expenditure, investments and financing operations made on the account of such revenue.

According to the 2018 State Budget Implementation Report, the state's revenue in 2018 amounted to 9.95 billion euros. The expenditure and investments incurred by the state amounted to 9.80 billion euros and 465.5 million euros, respectively. In 2018, expenditure and investments exceeded revenue by 318.6 million euros. It is not a surplus or deficit of the government sector which is calculated using other calculation methods - for more information see chapter "Financial Indicators for Public and Finance Sector" of the management report within the 2018 Consolidated Annual Report of the State.

According to the consolidated annual accounts of the state, the assets of the state as at 31/12/2018 amounted to 16.1 billion euros whereas the majority were fixed assets (forests, roads, buildings and machinery). Compared to the preceding period, the monetary value of assets has increased by 668.7 million euros.

As at 31/12/2018, the state's liabilities totalled 8.8 billion euros - an increase of 860.6 million euros compared to the preceding period. Long-term liabilities of 5.57 billion euros comprise the majority of liabilities. The state's loan commitments amount to 3.1 billion euros, having increased by 175.6 million euros compared to the preceding period. The pension commitments of the state amount to approximately 2.6 billion euros.

What did we find and conclude as a result of the audit?

The 2018 Annual Accounts of the State provide in all material respects a fair presentation of the state's financial position, financial performance and cash flows during the ended accounting period.

The NAO finds that the 2018 Budget Implementation Report of the state which shows budgetary revenue of 9.95 billion euros, expenses of 9.80 billion euros, investments of 465.5 million euros and financing operations of 49.0 million euros provides reliable information on the state's revenue, expenditure, investments and financing operations.

The NAO is of the opinion that the economic transactions of the state have in all material respects been carried out in compliance with the State Budget Act, the 2018 State Budget Act and the 2018 State Budget Act Amendment Act. This means that the NAO did not find any significant errors in the implementation of the State Budget Acts.

The main observations of the NAO are as follows:

- **Costs that are related to adjustments in pension provisions or to litigation are still not planned in the state budget.** As for the so-called non-monetary expenses, only depreciation costs and the expense arising from the residual value of fixed assets sold are included in the budget whereas other expenses like costs related to public sector pension provisions are not. Consequently, for some expenses in the 2018 State Budget Implementation Report, budgeting and implementation are recognised in different sections of the report meaning that the comparability of the budget and its implementation is not ensured.

- **The targeted reserve fund has been used to finance activities that are not compatible with the purpose of the reserve fund.** In conjunction with the transition to accrual-based budgeting in 2017, the targeted reserve fund was deployed to finance costs arising from changes in accounting policies. Including the Government of the Republic's decision made at the beginning of 2019, 36.9 million euros have been planned to this end for the period 2017-2022. The NAO finds that now, two years after said transition, the government areas should already be able to budget expenses that were previously funded from the targeted reserve.

- **As the optimal size of the Stabilisation Reserve Fund is not laid down by law and the Ministry of Finance has not provided its assessment, there is no idea as to the amount to be held in the fund for it to cover potential needs.** Over the last 15 years, the Stabilisation Reserve Fund (SRF) has been boosted on account of state budget surplus only once, the SRF and the Liquidity Reserve have shrunk, and the central government's liquid assets are in negative territory. This gives the NAO reason to believe there is a risk that the (low) level of reserves will be ignored if there are no rules to assess the adequacy of the SRF.

- **According to the Ministries and the Government Office, they lack sufficient authority and means to perform their functions under the Anti-corruption Act.** The Anti-corruption Act requires government agencies to ensure that officials adhere to their obligations and authorises the agencies to verify declarations of interest. According to agencies, the performance of both functions is complicated by the Personal Data Protection Act which provides that data on officials and persons related to them may be collected and processed only subject to their consent.

What did we recommend as a result of the audit?

Main recommendations by the NAO to the Minister of Finance, the Minister of Public Administration and the Minister of Justice:

- envisage expenses of notable amount in the state budget;
- ensure that government areas include all their expenses in the budget;
- devise principles for determining the optimal size of the Stabilisation Reserve Fund by assessing the nature and amount of any emergency expenditure to ensure the availability of sufficient reserves;
- assess the impact of the provisions of the Personal Data Protection Act on the performance of functions and exercise of

rights arising from the Anti-corruption Act, and develop a solution that allows complying with both said Acts.

Response of the Minister of Finance and the Minister of Public Administration: the Ministers agreed with most of the recommendations made by the NAO - save for those concerning the introduction of policies for managing national reserve funds - and undertook to take them into account.

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Opinion on the accuracy of the Annual Accounts 2018 and the regularity of transactions of the state

The state's annual accounts are accurate in all material respects

Accuracy of annual accounts

1. **The annual accounts of the state which indicate that the consolidated net result of the state in 2018 was -237,873,730 euros and the consolidated balance sheet total as at 31/12/2018 was 16,069,401,989 euros provide - in all material respects - fair presentation of the state's financial position, financial performance and cash flows during the ended accounting period, in accordance with Estonian financial reporting standards.**

The financial statements of state-controlled foundations and companies and the profit-making state agency are generally accurate

Opinions of audit firms on the annual reports of state-controlled companies and foundations and the profit-making state agency

2. The annual accounts of the state contain the financial indicators of companies and foundations controlled by the state and of the profit-making state agency. Audit firms have audited the annual accounts of these entities, and the NAO has taken their opinion into account in expressing an opinion on the state's annual accounts.

3. In most cases, certified auditors have issued unqualified opinions on the annual accounts for 2018 of state-controlled companies and foundations and the profit-making state agency with qualified opinions issued on the annual accounts of just one company.[1] In terms of its substance and scope the qualification did not carry sufficient weight to affect the NAO's opinion on the 2018 Annual Accounts of the State.

Predominantly, budget funds were used in accordance with the State Budget Act

Compliance with State Budget Acts

4. **According to the State Budget Implementation Report, the state's revenue in 2018 amounted to 9,946,957,168 euros,[2] expenditure to 9,800,059,573 euros,[3] investments to 465,534,186 euros, and financing transactions to 49,042,373 euros. The National Audit Office is of the opinion that the state's economic transactions were performed in all material respects in accordance with the State Budget Act, the 2018 State Budget Act and its amendment act.**

Findings of the NAO regarding the audited areas

Findings by the NAO

5. Table 1 provides an overview of policy areas audited by the NAO and the main findings regarding the conformity of economic transactions with the State Budget Acts and their recognition in accounts within the audited areas. The monetary value of operations is as shown in the 2018 unconsolidated income statement of the state.

[1] A qualified opinion was issued on the annual accounts of AS Nordic Aviation Group (qualification concerning the justification of discounting a loan).
[2] As per line „Revenue included in budget position" in the 2018 State Budget Implementation Report.
[3] As per line „Revenue included in budget position" in the 2018 State Budget Implementation Report.

6. Assessments are based on the premise that, in all material respects, transactions are correctly recognised in the accounts and implemented in conformity with the State Budget Acts.

Table 1. Audited policy areas and opinions by the NAO

Audited area	Monetary value in 2018 (in EUR)*	Are the transactions correctly recognised in the accounts?	Have transactions been effected in accordance with State Budget Acts?
Collection of revenue, incl. taxes and social security contributions, sale of goods and services, other revenue	9.1 billion	Yes	Yes
Receipt of support, incl. mediation of support	850.4 million	Yes	Yes
Granting of support, incl. mediation of support	5.2 billion	Yes	Yes
Effecting of **operating expenses** and assumption of commitments, incl. transferable taxes, labour and management costs, other operating expenses, financial expenses	4.8 billion	Yes	Yes
Transactions in state assets, incl. investments	465.5 million**	Yes	Yes
Depositing of public funds, incl. interest revenue from bonds, deposits and loans, other financial revenue	0.5 million***	Yes	Yes
Exercise of founder's rights in foundations, non-profit associations and the profit-making agency; state participation in legal persons governed by private law (purchase and sale of shareholdings and collection of dividends)	255.8 million***	Yes	Yes

* Monetary value given in absolute terms. ** According to the 2018 State Budget Implementation Report. *** According to the state's unconsolidated cash flow statement for 2018.

Observations on planning and use of state budget

Some expenses are not budgeted

Planning of non-monetary expenses

7. As from 2017 the state budget is accrual-based, similarly to accounting. The objective was to make data on the state budget and its implementation comparable with accounting data to provide a better overview of the use of money.

8. Another goal was to enhance the reliability of using state budget funds because the Ministry of Finance believes that accrual-based budgets reflect the economic aspects of decisions more accurately and take into account the overall impact, incl. non-monetary impact, of transactions. This goal has been attained only in part.

Non-monetary expenses are expenses that do not entail a cash payment or expenses where the exact amount and timing of payment are not known yet. Such expenses include, for instance, depreciation costs, expense arising from the residual value of fixed assets written off, cost of setting up appropriations.

9. In its last year's audit report the NAO noted that the accrual-based state budget did not include all non-monetary expenses and advised the Ministry of Finance to envisage non-monetary expenses of notable amount in the state budget. The Ministry undertook to review the concept for budgeting non-monetary revenue and expenditure and propose a solution specifying the basis, criteria and list for including in the budget such non-monetary revenue and expenses that do not affect the financial position of the government sector. However, the Ministry of Finance is yet to come up with said solution even though there were plans to use it in the State Budget Strategy (SBS) 2020-2023 developed in May 2019.

10. In 2019, the Ministry of Finance admitted that due to the transition to activity-based state budget as from 2020 and the related workload it has been unable to analyse this issue thoroughly enough. Therefore, SBS 2020-2023 was drafted using the old accounting principles. This means that, in terms of non-monetary expenses, only depreciation costs have been budgeted whereas other expenses like costs related to adjusting the public sector pension provisions have not (these are still recognised in human resource accounting). The Ministry of Finance has undertaken to lay down and implement the accounting principles starting from SBS 2021-2024.

Budget and its implementation are not comparable in the State Budget Implementation Report

Targeted reserve fund means funds earmarked in the reserves of the Government of the Republic for implementing activities it has approved whereby the authority to earmark such funds has been granted to the Minister of Finance.

11. The current budget planning rules do not require planning of non-monetary expenses other than depreciation costs and, to provide an example, the 2018 State Budget Implementation Report for the Ministry of Education and Research shows that the 790,236 euros received from the targeted reserve fund towards potential litigation costs have been recognised as expenses to be included in budget position whereas in terms of implementation, i.e. the cost of setting up the appropriation, this amount has been recognised as an expense not included in budget position and hence featuring a budget value of 0 euros. There are similar examples for the Ministry of Justice (49,564 euros), the Ministry of Foreign Affairs (44,305 euros) and the Ministry of the Environment (43,388 euros). Such practices compromise the comparability between the budget and its implementation.

12. **NAO recommendation to the Minister of Finance and the Minister of Public Administration:** envisage non-monetary expenses of notable amount in the state budget to ensure comparability between the budget and its implementation.

Response from the Minister of Finance and the Minister of Public Administration: The issue of recognising non-monetary expenses in the state budget is continues to be topical for the Ministry of Finance and we should propose an appropriate solution. Unfortunately, in conjunction with the transition to activity-based budgeting and the related workload we have been unable to analyse this issue thoroughly enough in the context of SBS 2020-2023. Therefore, SBS 2020-2023 was drafted using the old accounting principles (for example, long-term pension commitments are still recognised in human resource accounting). We are currently working to lay down and implement revised accounting principles starting from SBS 2021-2024. We take this matter into account in developing the legal framework of the state budget, incl. in the process of amending the State Budget Act.

Amount of funds transferred was lower than usual

Problems with using capped budgets and understanding accrual-based budgeting

Transfer of state budget funds means extending the time limit for using the state budget funds by a period of one budgetary year.

Source: State Budget Act, § 33 (1)

Funds with and without limits – budget that is specified upon the adoption of the annual Budget Act and may not be exceeded.

Budget position – difference between the total revenue and total expenditure of government sector.

13. According to the rules for transfer set out in the State Budget Act and pursuant to the 2018 State Budget Act, the maximum limit for the transfer of budget funds with and without limits is 3%. In the course of drafting the 2019 state budget the Government of the Republic made a decision to improve the budget position and transfer 1%. As a result, about 21.6 million euros less were transferred from 2018 to 2019 as compared to the preceding period.

14. This forced the government areas to exhaust the budget for predetermined expenses which would otherwise have been returned to the state budget.

For your information

The unused budget funds that were not transferred to 2019 amounted to 22.9 million euros.

15. Subsequently, the NAO identified errors in assigning expenses to proper periods in at least three government areas as expenses were recognised in 2018 even though goods or services were actually received in 2019 - meaning that these expenses should have been assigned to the following budget year.

Accrual-based budgeting rules require explanation

16. Government agencies have not yet fully understood the new rules enforced upon the transition to accrual-based budgeting, i.e. the fact that budget implementation now depends on when the goods or services were received rather than when the goods or services were paid for. For instance, auditors repeatedly noticed comments accompanying endorsed invoices which read that the invoice should certainly be paid before 31 December 2018 which means that officials still observe the rules for cash-based implementation.

17. In effect, these were expenses to be made in 2019 which, as a result of the audit, were properly recognised as part of implementing the corresponding year’s budget. However, there is a risk that the decision by the Government of the Republic could lead to a situation where the government areas’ budgets for 2019 will not have sufficient funds for the planned activities.

Use of the targeted reserve fund for recognising expenses in line with the accrual method

18. The NAO finds that the fact that government agencies do not fully understand or embrace accrual-based budgeting is also evidenced by how much the targeted reserve fund is used for accrual adjustments, i.e. they request additional money from the Ministry of Finance to recognise transactions according to the accrual method.

For your information

According to the Minister of Finance and the Minister of Public Administration, the idea behind setting up the targeted reserve fund was to avoid additional decision-making procedures within the government for substantive decisions where the precise timetable, budget distribution across the years, and other similar details are not known at the time of making the decision. Planning such funds in the government area's budget is not reasonable because the *targeted* reserve allows redirecting the funds as necessary by means of a decision of the Government of the Republic (once the detailed timetable, amounts, etc. become clear). Otherwise, the funds would remain in the government area's budget where, in extreme cases, they can be redirected only at year-end by means of a legislative amendment. The described solution ensures optimal and flexible use of the state budget.

Source: response from the Minister of Finance and the Minister of Public Administration to the audit report on the accuracy of Annual Accounts 2017 and regularity of transactions of the state

19. The explanatory memorandum to the 2017 state budget provided for 12.39 million euros for accrual adjustments whereas the decision of 28 February 2019 of the Government of the Republic grants additional 24.51 million euros for the period 2018-2022, thus totalling 36.9 million euros.

20. For example, in 2019, a total of 1,14 million euros have been allocated to four government areas for adjustments related to 2018 meaning that no funds were planned in their budgets for assigning economic transactions made in 2018 to the proper budget year. In this case, at least 823,436 euros of this amount represents potential litigation costs which are not compatible with the purpose of the targeted reserve fund.

21. The NAO finds that government areas should include all expenses in their budgets, including those for which they currently request funding from the targeted reserve. This would improve the transparency of budget decisions and provide the Riigikogu with a better overview of the government area's annual budget.

22. **NAO recommendations to the Minister of Finance:**

- explain the principles of accrual-based budgeting to agencies in coordination with the government area's budget managers so as to ensure the accuracy of data supplied in budget implementation reports;
- ensure that government areas include all their expenses in the budget.

Response from the Minister of Finance: We agree and undertake to explain the principles of accrual-based budgeting to agencies, including at the meetings of the network of finance managers.

As for now, we have considered it reasonable to recognise the adjustments caused by the transition to accrual-based budgeting in the targeted reserve fund in view of earlier decisions, and explained the reasoning behind this to the NAO in the framework of the audit report on the accuracy of Annual Accounts 2017 and regularity of transactions of the state. However, we agree that there is a need to conduct further analysis in the course of preparing the SBS 2021-2024 to determine whether it would more practical to recognise the adjustments caused by the transition to accrual-based budgeting in the budgets of respective government areas.

The policies for managing reserve funds need further revision

National reserve funds are shrinking

23. The state has two reserve funds: the Stabilisation Reserve Fund (SRF) and the Liquidity Reserve (LR) managed by the State Treasury Department of the Ministry of Finance.

24. The market value of the SRF was 411.5 million euros as of the end of 2018 having diminished by 0.2% during the year (see Table 2). The reserve fund appreciated on the account of annual profit allocations from the Bank of Estonia totalling 1.1 million euros but as the fund's investments had negative yields due to the situation on the international money market the total value of the reserve fund shrunk by 0.7 million euros.

25. Over the last 15 years the SRF has received allocations from the state budget only once - in 2015 - when the 2014 surplus amounting to 24.7 million euros was credited. In 2009, 223.7 million euros (EEK 3.5 billion) were deployed to mitigate general economic risks resulting from the global financial crisis.

The deficit of central government's liquid assets increased by 177.9 million euros

26. The Liquidity Reserve totalled 676.6 million euros as at the end of 2018 and shrunk by 8.9% or 66.6 million euros compared to the preceding year. The Liquidity Reserve's market value has fluctuated a lot on monthly basis: ranging from 517 million euros in April to 872 million euros in September. The central government's share in the Liquidity Reserve amounted to -642.5 million euros (-464.6 million euros as at 31/12/2017); this situation was possible only because the money of other entities included in the reserve (mostly the money of Estonian Unemployment Insurance Fund and Estonian Health Insurance Fund) was used to cover the negative balance generated by the central government and maintain the reserve above the threshold.

Table 2. Market value of reserve funds, incl. of the Liquidity Reserve, from 31/12/2013 to 30/06/2019, broken down by entities (in EUR million)

	31.12.2013	31.12.2014	31.12.2015	31.12.2016	31.12.2017	31.12.2018	30.06.2019
Stabilisation Reserve Fund	**360.9**	**368.9**	**398.5**	**406.0**	**412.2**	**411.5**	**415.4**
Liquidity Reserve, incl.	**1,055.3**	**1,125.0**	**747.9**	**784.9**	**743.2**	**676.6**	**987.8**
▪ state (central government)	*204.6*	*198.0*	*-331.6*	*-355.2*	*-464.6*	*-642.5*	*-504.0* *(-704.0)**
▪ total for other entities, incl:	*850.8*	*927.0*	*1,079.5*	*1,140.1*	*1,206.8*	*1,319.1*	*1,491.8*
▪ Estonian Health Insurance Fund	199.6	176.4	152.9	119.6	121.0	148.6	143.8
▪ Estonian Unemployment Insurance Fund	535.5	613.0	663.2	702.4	777.1	832.7	955.4
▪ foundations	108.9	119.7	238.2	274.9	272.6	309.9	359.8
▪ European Commission	6.6	17.9	25.3	43.2	36.1	22.7	32.3
Total reserves	**1,416.2**	**1,493.9**	**1,146.4**	**1,190.9**	**1,155.4**	**1,088.1**	**1,403.2**

* Share of central government in the Liquidity Reserve, excluding bonds totalling 200 million euros emitted in June 2019.

Source: Statements of state reserves by the State Treasury Department of the Ministry of Finance

27. Central government's payments have constantly exceeded its receipts over the recent years (see Table 2). According to explanations provided by the Ministry of Finance, the sudden drop in the central government's liquid assets in 2015 was mostly due to the ending of the EU financial period and the resulting extension of time limits for disbursements. Even though the money had already been paid to beneficiaries under bridge financing, it was yet to be collected from the European Commission.

General government budget position – difference between total revenue and total expenditure of government sector.

Cash-based adjustment – replacing accrued tax revenue with cash-based data, i.e. actually received amounts, so as to obtain reference data for drafting statistics on public finances.

28. In 2018, the cash flows of the State Treasury amounted to -179 million euros mostly due to the general government budget position of -220 million euros (accrual-based). Further factors included cash-based adjustments to taxes and foreign aid (-37 million euros) and financing transactions amounting to 11 million euros. Plus loan repayments of 17 million euros and an increase of 83 million euros in the reserves of social security funds. Hence, the main reason behind the negative cash flows in 2018 was the state budget deficit.

29. According to the forecast by the Ministry of Finance and given the SBS decisions, the cash flows for 2019 will be -250 million euros whereby about half of it is attributable to the general government budget position.

Liquidity Reserve dropped below target level

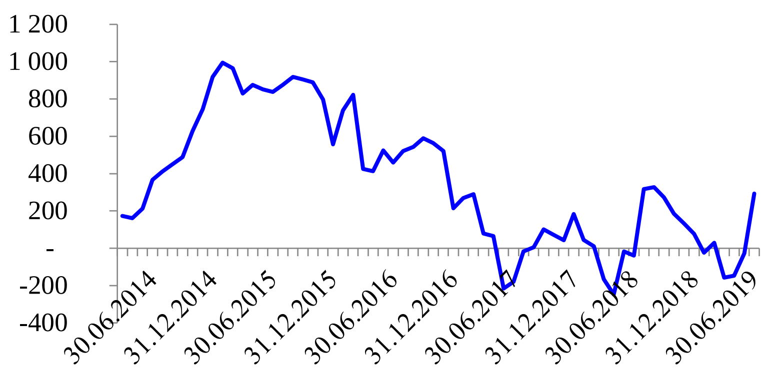
Target level - calculated by the State Treasury at least once a year taking into account (1) the impact of the last economic downturn or an even more negative scenario on the government's six months' tax revenue, (2) the amount of interest and principal required to service government debt for one month, (3) average payments from the Social Insurance Board and social security funds over one month, and (4) government's potential commitments that are likely to become payable.

Source: Ministry of Finance

Liquidity Reserve's surplus/deficit - calculated by subtracting the total of LR funds and unused loans from the target level.

30. The main reason behind the contraction of Liquidity Reserve (LR) in 2018 and 2019 is that the central government's spending exceeds the amount of money from other entities accumulating in the LR. Also, there have been periods where the negative cash flows of the central government have caused the LR level to drop below the target level calculated by the State Treasury (see Figure 1).

Figure 1. Liquidity Reserve's surplus/deficit from 31/03/2014 to 30/06/2019 (in EUR million)



Source: NAO's calculations based on the statements from the State Treasury

Framework for issuing short-term bonds - allows repeated issuing of discounted bonds with a maturity of up to one year. The total value of bonds is capped at 400 million euros.

Source: Ministry of Finance

31. In March 2019 the Minister of Finance adopted a framework for issuing short-term bonds. In June the State Treasury emitted 200 million euros worth of short-term bonds to manage government's cash flows - half of which had a maturity of six months and the other half twelve months. As a result, the LR level has improved as at 30 June 2019 compared to the end of the previous financial year.

32. Given that according to the current trend the central government's spending exceeds revenue the NAO finds it likely that government debt will grow further.

Stabilisation Reserve Fund

33. Over the past two years the NAO has suggested that the Minister of Finance should devise principles for determining the optimal size of the Stabilisation Reserve Fund (SRF) and determine the calculation methods, assess the nature and amount of any emergency expenditure, and ensure the availability of sufficient reserves. At the moment, there is no agreement or legislation defining the payments or the period to be covered by the SRF in a crisis situation. As the requirement to maintain a balanced state budget was abolished in 2017, the NAO believes there will be less possibilities for the government to boost the SRF on the account state budget surplus.

34. The Ministry of Finance argues that the current practice of increasing the SRF is appropriate and there is no need for developing an additional regulatory framework. Priority is given to crisis prevention and the SRF would be deployed in emergency situations only. In the event of a crisis, an alternative solution to deploying the SRF would be borrowing, cost cutting or postponement of investments.

35. Despite annual profit allocations from the Bank of Estonia, the SRF's market value has dropped along with the value of the LR. Therefore, the NAO lacks assurance that the (low) level of reserves would be addressed in good time, i.e. when it is still possible to channel additional funds in the reserves. In the light of the foregoing, the NAO continues to uphold its recommendations: the criteria for determining the optimal size of the SRF should be laid down as without them the SRF's optimal size cannot be calculated or the availability of sufficient reserves ensured.

Use of money of the Health Insurance Fund and the Unemployment Insurance Fund

36. In three previous years, the NAO has pointed out that using the reserves of the Estonian Health Insurance Fund (EHIF) and the Estonian Unemployment Insurance Fund (EUIF) for managing liquidity problems is not in conformity with the Estonian Health Insurance Fund Act or the Unemployment Insurance Act.

37. In its 2015 audit report on the annual accounts, the NAO maintained that the right of the Ministry of Finance to use the money of EHIF/EUIF for purposes other than their own payments, whether on temporary or more permanent basis, has not been expressly set out in the Estonian Health Insurance Fund Act or the Unemployment Insurance Act. Furthermore, according to said Acts, EHIF/EUIF are public law entities which may not grant loans or secure the (loan) commitments of other entities, meaning that the reserves of EHIF/EUIF should be managed in line with the same principles as the SRF.

38. The Ministry of Finance has explained each year that it has acted in view of the State Budget Act and the fact that 7 December 2011[4] the legislator made an informed decision and amended the Estonian Health Insurance Fund Act and the Unemployment Insurance Act to allow using the money of EHIF/EUIF held by the State Treasury according to a holding agreement for the purpose of offsetting the negative cash flows of the state.

39. The Ministry of Finance has consistently maintained that when authorising the Ministry of Finance to consolidate the money of EHIF/EUIF the Riigikogu intended to streamline the management of public sector cash flows and debt commitments, and that managing the legal reserves of EHIF/EUIF according to the same principles as the SRF is not reasonable.

40. However, the NAO continues to maintain that the legal reserves of the EHIF/EUIF should be managed in line with the same principles as the

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[4]In conjunction with the 2012 State Budget Act: the Act Amending Alcohol, Tobacco, Fuel and Electricity Excise Duty Act, Estonian Health Insurance Fund Act, Local Government Financial Management Act and Unemployment Insurance Act.

SRF. Similarly to the SRF, the EHIF/EUIF have a statutory obligation to maintain their legal reserves to manage any risks arising from macroeconomic changes.

41. NAO recommendations to the Minister of Finance and the Minister of Public Administration:

- devise principles for determining the optimal size of the Stabilisation Reserve Fund and regulate the calculation methods, assess the nature and amount of any emergency expenditure, and ensure the availability of sufficient reserves;

- Initiate the amendment of the Estonian Health Insurance Fund Act and the Unemployment Insurance Act to legitimise the use of EHIF/EUIF money for the government's liquidity management;

- manage the legal reserves of EHIF/EUIF that have been set up to mitigate risks from macroeconomic changes in line with the same principles as the SRF.

Response from the Minister of Finance and the Minister of Public Administration: The Ministry of Finance (MF) finds that the applicable practice for increasing the Stabilisation Reserve Fund (SRF) is adequate and there is no need to set an additional ceiling for the size of the SRF. The SRF grows mostly on the account of cash flow surplus, profit allocations from the Bank of Estonia, and other irregular revenue. Boosting the reserve on the account of current revenue would mean using the cash flow surplus to withdraw additional funds from the economy which would excessively compromise economic growth. The SRF is an important tool for managing crises and emergencies and its symbolic value is to show that the state is ready for crises. However, in crisis situations, the MF cannot rely solely on the SRF because, firstly, it is extremely difficult to estimate the likelihood of various crises (natural disaster, economic crisis, financial crisis, war) and the level of ensuing expenditure. Secondly, in addition to deploying the SRF, the state can take a loan, cut costs or postpone investments in order to manage the crisis. Nevertheless, prevention of crises and more effective risk management are paramount. The SRF will be deployed only in emergencies. The MF aims to ensure that the state's risks are managed in a way that allows the state to finance its commitments in crisis situations without having to resort to the SRF or so that its deployment is postponed for as long as possible. For example, in a crisis, the state can address international crisis management funds (ESM, IMF) or other countries to borrow money. The SRF was last deployed in 2009 when 224 million euros were withdrawn to mitigate macroeconomic risks resulting from the global economic crisis. Also, two negative supplementary budgets were drawn up in 2009 to cut state budget expenditure by 584 million euros. Back then, IMF's assistance was not needed and the ESM did not exist yet. This demonstrates that deployment of reserves is not the only or primary tool for crisis management.

Just as in previous years, the MF continues to maintain that § 39 (1) of the Estonian Health Insurance Fund Act and § 341 (1) of the Unemployment Insurance Act clearly provide that a deposit agreement shall be entered into between the government and EHIF/EUIF. The Riigikogu has authorised the use of the money according to § 67 (2) of the State Budget Act which stipulates that the government may use the deposited money provided that the owners of the money can make payments on account of their money any time. Based on the recommendations from the NAO we have asked the Ministry of Social Affairs to amend the Estonian Health Insurance Fund Act and the Unemployment Insurance Act as both of these Acts concern their government area (Legislative Drafts Information System, file No. 18-0795).

The MF points out that the Riigikogu assembled all the funds of the EHIF and the EUIF to be centrally managed by the Ministry of Finance in view of the following policies:
1. Improve the management of cash flows and debt commitments in the public sector because:
a) harmonised cash flow management and higher liquidity ensures more efficient use of the state's available financial resources;
b) harmonised conservative investment policies yield cost savings for EHIF/EUIF, and the entire state budget.
2. The MF ensures liquidity of the funds of EHIF/EUIF and any investment losses will not be attributed to them. Further, the EHIF/EUIF need no longer pay for costs related to bank transfers and investment operations. At the time of deciding this, the Riigikogu argued that the positive effect of harmonised cash flow management on the state budget and the EHIF/EUIF outweighs the assumption of increased financial risk ensuing from the presumably longer period of using the reserves of EHIF/EUIF. Investing part of the legal reserves of EHIF/EUIF according to the same principles as the SRF money has been under consideration for several times but it has not been found that it would be reasonable given the objectives set out in legislative amendments made in 2011.

Comment from the NAO: The NAO agrees that there is no need to set a ceiling for the size of reserves. The NAO finds that it is necessary to develop a calculation methodology for the Stabilisation Reserve Fund (SRF) to ensure the availability of sufficient reserves.

Likewise, the NAO continues to maintain that the legal reserves of EHIF/EUIF should be managed in line with the same principles as the SRF. Similarly to the SRF, the EHIF/EUIF have a statutory obligation to maintain their legal reserves to manage any risks arising from macroeconomic changes.

There are no controls to avoid duplication of project funding

Risk of duplication of project funding

42. According to the unconsolidated income statement contained the 2018 Consolidated Annual Report of the State, foundations granted domestic earmarked funding in the amount of 469 million euros. Domestic funding for projects is granted by a number of government agencies who review applications and reports in various databases - mostly document management systems - that are not linked to one another. This entails a risk that funding for the same project is requested and received from several donors.

43. The auditors learned that different Ministries have granted funding for the implementation of the same projects. Such overlapping of projects (and expense receipts) might not be identified because donors have no idea which expenses have been financed by other agencies. The current domestic funding system allows applicants to request project funding from several government agencies.

44. Funding is sought from various sources because the total cost of the project might exceed the maximum amount made available by a donor. Also, reporting on the use of funding is not standardised which means that donors do not receive equivalent data from beneficiaries. In turn, this entails a risk that donors have no information to allow verifying that the same invoices are not financed from different sources.

45. The NAO has pointed out in its earlier audits - the 2007 audit report on local government investments[5] and the 2010 audit report on ranting cultural, sports and youth work funding to citizens' associations from municipal budgets[6] - that reports on the granting and use of funding lack sufficient transparency. The NAO has repeatedly highlighted the need to make all use of public funds transparent.

46. For instance, the Ministry of Justice and the Ministry of Culture require beneficiaries to disclose to donors information on entities that have provided co-financing. This way donors can find out whether there are other government agencies funding the project. However, there is no assurance that beneficiaries submit exhaustive information on co-financiers and amounts of funding which means that any misuse of funding might not be detected and beneficiaries could escape potential penalties.

SFOS or Register of Structural Aid – information system for collecting statistics and financial data necessary for keeping account of the granting and use of funding, providing the European Commission with the relevant information, managing and monitoring the granting and use of funding, and making disbursements.

Source: data from the management system of national information systems

47. The Ministry of Social Affairs assigned the management of applications, payments and reporting related to projects financed on the account of gambling tax to the Centre of State Support Services (CSSS) at the beginning of 2019. The CSSS uses the Register of Structural Aid (SFOS) to manage these projects.

48. Users can access the SFOS and the information systems of the Environmental Investment Centre (EIC) and the Agricultural Registers and Information Board (ARIB) to check whether the applicant has participated in any previous projects using the applicant's registration number and name. Upon inputting an expense receipt, the SFOS automatically checks whether a receipt of the same date and amount has been previously entered and displays a relevant message whilst also prompting the user to conduct cross-validation where necessary. In that case, the system cross-validates the expense receipt within the SFOS and submits queries to external information systems (EIC and ARIB) to check for overlapping.

49. The NAO argues that the risk of fraud related to project applications could be managed by a shared information system on project funding with one of its features being the detection of invoices where payments overlap. The NAO believes that as the development of a new information system is expensive and entails administrative costs it would be

[5] NAO audit report of 30 August 2007 on „Investments of local authorities".
[6] NAO audit report of 25 February 2010 on „Granting cultural, sports and youth work funding to citizens' associations from municipal budgets".

reasonable to include the processing of funding applications and reporting in the current information system, for example, the SFOS.

50. **NAO recommendation to the Minister of Public Administration:** examine the possibility of including the processing of domestic funding applications in the Register of Structural Aid (SFOS) to avoid duplication of funding and manage the risk of fraud.

Response of the Minister of Public Administration: We agree with the recommendation as avoiding the duplication of funding is one of the preconditions set by the European Commission for using European structural and investment facilities (specific activities performed by the same target group may be supported from different sources at the same time if this is in line with the principle of budget neutrality or if the European Commission intends to combine the use of various facilities for the same project during the new EU programming period - however, double reimbursement of costs must be prevented). The Ministry of Finance is looking for solutions to address the risk of double reimbursement and considering, among other options, using the SFOS to this end. We are analysing other alternatives to improve the centralised management and availability of information on project funding. Processing all funding applications in the SFOS might not be optimal because the SFOS has been designed to implement specific rules related to granting EU aid. However, we will analyse the harmonisation of criteria for granting of funding and reviewing of applications in the course of drafting the State Budget Strategy and the actual state budget to ensure that all amounts granted from the budget towards project funding are used purposefully and efficiently. We will consider the options available to us as part of the process of developing national strategic planning and financial management in H2 2019 and in 2020.

Information systems that support financial reporting have become more effective and reliable

Information systems essential for financial reporting

51. In its audit concerning FY2017 the NAO took a closer look at information systems used to process data which have relevance beyond the agency's core functions, specifically in terms of financial accounting. A total of 20 information systems were audited back then. The auditors identified a number of issues and sent Management Letter to the managers of information systems detailing their findings and recommendations. This time, the NAO focused mainly on follow-up of said findings. Plus, it audited two new information systems: the Visa Register and the Road Tax Information System. For audited information systems please see Annex 1.

For your information

The following areas were analysed to assess reliability:

- ISKE (three-level reference security system for information systems) audits of information systems,
- availability and relevance of data security policy,
- management of access rights,
- system logins and relevant monitoring,
- backups,
- agency's physical security,
- management of information system modifications,
- auditing of information system applications.

Reliability of audited information systems

52. Both the audit concerning FY2017 and this audit examined the reliability of information systems in terms of financial accounting.

53. Main observations in the previous audit report related to the omission of ISKE audits and a number of shortcomings in the management of access rights. For instance, access rights were not inventoried regularly or with due care or there were no internal rules of procedure for this at all, and some individuals whose duties had changed or who had left employment still remained users of the system even though they no longer needed access to it. Also, activity logs were not analysed and procedures for this were not established. System recovery tests were usually not documented.

54. The managers of information systems have notably improved their efforts to ensure the security of systems over the last year, and several shortcomings identified previously were either eliminated or less prevalent. For example, the FY2017 audit revealed that regular ISKE audits had been omitted for six information systems but last year the number of such systems was only two. Previously, nearly all audited databases had problems with the management of access rights but this time there were only four problematic databases. The identified shortcomings related to taking inventory of rights and to the scope of rights granted to specific users.

55. All in all, the NAO did not identify any shortcomings in the operation of information systems that could significantly affect the quality of financial data based on these systems.

56. The NAO sent Management Letters containing detailed information on shortcomings and its recommendations for addressing these to the Secretaries General of relevant Ministries.

Overview of internal controls put in place by the Ministries and the Government Office to prevent corruption

Internal controls put in place to prevent corruption

57. The 2013 Anti-corruption Act (ACA) is more flexible than the previous legislation and sets out fewer specific restrictions on officials. However, this puts a greater responsibility on agencies to design effective internal controls.

58. The NAO examined the internal controls put in place by Ministries and the Government Office to comply with their statutory obligations stemming from the ACA. To this end, auditors conducted interviews and reviewed the agencies' internal rules to learn how corruption risks are assessed, which internal controls have been put in place to prevent corruption, how are the officials monitored for compliance with their obligations, who is required to declare their interests and whether such declarations are reviewed, and how do the agencies ensure the disclosure of transactions with related parties in the annual report.

Related parties include the members of the highest governing bodies, executives, and their family members, including spouses, unmarried partners and children, as defined in the accounting policies and procedures of the government area as well as foundations, non-profit associations and companies where the aforesaid persons either individually or collectively with their family members have control or significant influence.

59. The Ministry of Justice had planned to conduct a survey on the implementing practices of the ACA based on the operational programme of the Anti-corruption Strategy (ACS) 2013-2020 to identify any bottlenecks in implementing the ACA and subsequently propose legislative amendments as necessary. However, the 2018 Implementation Report on the ACS operational programme reveals that the Ministry abandoned its plan because it believes that there is no need for such a survey. According to the Ministry, it intends to focus more on prevention and awareness raising.

60. But the overview prepared by the NAO shows that there are bottlenecks and uncertainties related to implementing the ACA.

Corruption risks have not been assessed systematically

Assessment of corruption risks

61. The Ministries and the Government Office (hereinafter also referred to as "agencies") stated that they have not paid special attention to corruption risk assessment and consider their existing internal controls to be adequate. The agencies' internal rules that govern their work arrangements do not specify risk assessment procedures, their regularity or the entities responsible for risk assessment (officials or structural units).

62. The NAO finds that effective internal controls require identifying job positions and activities that are at risk of corruption. The next step would be systematic assessment of the likelihood and potential impact of violations by each official, and making necessary adjustments to internal controls.

63. According to the agencies, they have considered and acknowledged the areas that are most susceptible to corruption and conflicts of interest but have not engaged in systematic risk assessment. These issues have been addressed indirectly by including preventive measures in internal rules and expanding the list of officials required to declare their interests.

64. Some years ago the Ministry of Justice and the Ministry of Finance assessed the corruption risks of each job position and identified individuals who need to declare their interests on an annual basis.

65. **NAO recommendations to the Minister of Justice and the Minister of Public Administration:** explain the necessity of corruption risk assessment to agencies and suggest proper practices.

Response from the Ministry of Justice: Assessment of corruption risks is essential and reminding the agencies of its necessity is appropriate. We assure that in the context of implementing anti-corruption policies and providing advice related to the Anti-corruption Act we have always pointed out that each agency should, in view of its specific circumstances, identify the corruption risks of officials acting on its behalf or under its supervision and take the corresponding mitigation measures. To this end, agencies need to map their activity areas and processes and job positions that are susceptible to corruption.

The Ministry of Justice can provide explanations and disseminate the best practices through the anti-corruption network for liaison officers. For instance, in 2019 the Ministry teams up with the internal auditors of other Ministries to assess the corruption risks of Ministers and their political advisers. The Ministry expects the NAO to detail on its recommendation to suggest "proper practices" for the assessment of corruption risks.

Corruption risk is a type of risk that is assessed in the same way as other types of risk. In 2013, the Ministry of Finance developed risk management guidelines titled “Risk management” that might need revision and updating but the principles therein are applicable today. See https://www.rahandusministeerium.ee/et/riigihaldus/organisatsioonide-juhtimiskvaliteedi-arendamine.

Response of the Minister of Public Administration: We find that the recommendation is relevant and justified. With guidance from the Ministry of Justice we will continue nationwide harmonisation of the methodology for corruption risk assessment and development of the relevant guidelines. The current initiative of the Ministries’ liaison officers for anti-corruption and internal auditors which is led by the Ministry of Justice and aims to map the corruption risks of Ministers and political advisers is an important step here. Centralised training courses on ethics and corruption prevention provided annually by the Ministry of Finance in coordination with the Centre of State Support Services help build the competencies required to assess corruption risks.

Comment from the NAO: The NAO finds that the Ministry of Justice and the Ministry of Finance should updated the guidelines for corruption risk assessment as they both claim that the guidelines require revision. The NAO intends to monitor the relevant progress on an ongoing basis.

Avoiding conflicts of interest is not always ensured in public procurement

Prevention of corruption risks

Internal controls for preventing corruption include, for instance, the reporting obligation, withdrawal obligation, statement of independence, four-eyes principle, committee procedure.

66. Effective prevention of corruption requires written rules and guidelines. These help ensure that preventive measures are actually implemented. Usually, internal rules and guidelines set out internal controls for preventing corruption. In some cases, internal rules did not specify the obligations of officials or the action to be taken if there is a risk of violating procedural restrictions.

67. The auditors examined in detail the procurement rules which - in the agencies’ opinion - entail a high risk of corruption. The Public Procurement Act (PPA) that entered into force in autumn 2017 pays more attention to avoiding conflicts of interest. According to the PPA, procurement rules or other internal documents on work arrangements must set out measures for preventing, identifying and eliminating conflicts of interest related to public procurement.

68. The audit revealed that, on multiple occasions, the wording of the relevant measures in the procurement rules was such that independence was to be stated only if required for a specific public tender or a conflict of interests be declared only if there is a connection with the tenderer. The NAO argues that procurement rules should provide that the declaration of no conflict of interests should be mandatory for each public tender.

69. Already in its audit report on the accuracy of Annual Accounts 2016 and regularity of transactions of the state, the NAO recommended that the Minister of Public Administration should make statement of independence mandatory and advise contracting entities to introduce relevant measures that do not increase the administrative burden. Statement of independence allows officials to acknowledge the applicable procedural restrictions and helps to ensure that public funds are used in a fair, transparent and unbiased manner. The relevant statement could be included in the procurement committee's report to avoid increasing the administrative burden. Persons participating in the preparation of the public tender should also be required to make such statement.

70. **NAO recommendation to the Minister of Public Administration:** consider making the statement of independence mandatory for all public tenders and advise contracting entities to introduce relevant measures that do not increase the administrative burden.

Response from the Minister of Public Administration: Avoiding conflicts of interest in public tenders has become more topical since 1 September 2017 as the Public Procurement Act (PPA) that entered into force on that date requires contracting entities to set out - in their procurement rules or, failing these, in other internal documents on work arrangements - measures for preventing, identifying and eliminating conflicts of interest related to public procurement.

The Ministry of Finance (MF) analyses the conformity of procurement rules with PPA provisions using, among other things, random sampling as part of public procurement monitoring. If there are shortcomings, the contracting entities will receive recommendations and guidelines for adjusting their procurement rules.

The MF has addressed prevention of corruption and conflicts of interest in the framework of training sessions held in 2019 (materials publicly available in the self-service portal for government employees). The web site of the MF provides access to a manual titled “Addressing conflicts of interest in public sector” and features a link to the web site korruptsioon.ee where the Ministry of Justice has published a number of relevant guidelines. At the end of 2018, the MF web site published the “Indicative guidelines for designing internal controls in local government bodies” which contains recommendations for avoiding conflicts of interest, including in conjunction with public tenders. The latter guidelines can be used by agencies covered by this audit too.

The PPA requires contracting entities to determine appropriate measures for preventing, identifying and eliminating conflicts of interest. Given that contracting entities differ as to their staff number, work flows and procurement practices (for example, making use of centralised procurement services changes procurement practices considerably), we maintain that it would be reasonable to let the entities determine the appropriate measures and their methods of implementation without setting out in the PPA any additional mandatory requirements that would apply universally to all contracting entities.

The MF supports cutting red tape meaning that any additional mandatory requirements to contracting entities should be strictly necessary. We would like to point out that the statement of no conflict of interest related to the public tender can be included in documents like reports or decisions drawn up by the contracting entity. Even though the documents automatically drafted by the Public Procurement Register (PPR) do not contain this statement as of now, contracting entities are free to add it. Further, in the PPR the contracting entities can add to each public tender internal documents like a statement of no conflict of interests by a person related to the preparation or implementation of the tender process.

In conclusion, we find that the MF can continue to support the avoidance of conflicts of interest in public tenders by counselling and monitoring contracting entities and, insofar as practicable, adding the relevant tool in the PPR to help contracting entities without increasing their workload.

Comment from the NAO: The NAO supports the Ministry of Finance's idea to add a relevant tool in the Public Procurement Register that helps contracting entities avoid conflicts of interest. The NAO will plan activities to analyse its introduction in the next audit.

Officials are not systematically monitored for compliance

Compliance monitoring

The Anti-corruption Act sets out a number of obligations imposed on officials. Officials are prohibited from demanding, intermediating or accepting income derived from corrupt practices. Corrupt use of official position, public resources, influence or insider information is also prohibited. Further, officials must comply with restrictions on activities and procedural restrictions.

71. The Anti-corruption Act (ACA) requires government agencies to monitor compliance with obligations imposed on officials. The ACA does not specify how this should be done meaning that agencies themselves must develop proper and effective practices. However, none of the agencies have conducted systematic compliance monitoring in recent years.

72. According to them, they have no tools for meeting this requirement. Further, they pointed out that such monitoring is complicated because the Personal Data Protection Act (PDPA) provides that data on officials and persons related to them may be collected and processed only subject to their consent. The NAO points out that the obligations of officials include a multitude of requirements where compliance can be monitored regardless of access to personal data.

73. The agencies' internal rules do not specify how should compliance with obligations imposed on officials be monitored. Only a few Ministries have designated a position or structural unit responsible for this. According to agencies, they have focused on internal controls for preventing corruption so as to avoid transactions that are subject to conflicts of interest, and on awareness raising to promote a preventive organisation culture and avoid violations of the ACA.

Procedural restrictions are designed to avoid conflicts of interest and prohibit officials from making decisions or conducting procedures under certain circumstances. For instance, if a decision or procedure would involve the official himself or a person related to him or if the official is aware of the corruption risk associated with the decision or procedure. However, restrictions are not unconditional and may be waived in some cases like emergency situations.

74. Compliance with procedural restrictions has been monitored as and when necessary. Five Ministries assure compliance with procedural restrictions by requiring the highest governing bodies and executives to file statements where they declare that they have not entered into transactions that involve related parties or are incompatible with the legislation or the market situation.

75. The Ministry of Social Affairs that compliance with procedural restrictions could be monitored by using a respective box in the self-service portal for government employees where officials as defined in the ACA could list persons related to them. This would allow agencies to perform their statutory function and check whether there have been any transactions with related parties which should be disclosed in the annual report. The NAO finds that identification and disclosure of transactions with related parties could be done using a technological solution that allows officials to list businesses that are associated with him or his close ones.

76. Rules for notifying of ancillary activities have been put in place in conjunction with restrictions on activities but compliance with the notification requirement or the completeness of submitted information is not monitored. Only the compatibility of ancillary activities with the officials’ core functions and professional routines is assessed.

77. The NAO argues that the Ministry of Justice should advise government agencies how to strike a balance between the restrictions arising from the PDPA and the obligations set out in the ACA so that agencies could perform their statutory functions under the ACA whilst ensuring the protection of personal data and privacy.

78. **NAO recommendations to the Minister of Justice:**

- assess the impact of the provisions of the Personal Data Protection Act on the monitoring of compliance with obligations set out in the Anti-corruption Act, and develop a solution that allows complying with both said Acts;
- develop guidelines for monitoring the compliance of officials with their obligations;
- in coordination with the Ministry of Finance, develop a technological solution for registering persons associated with officials.

Response from the Ministry of Justice: You have recommended that the Ministry of Justice should assess the impact of the provisions of the Personal Data Protection Act (PDPA) on compliance monitoring (the NAO has failed to specify the obligations in paragraph 78; we assume that these are obligations set out in § 3(3)(2) of the Anti-corruption Act (ACA)) and noted: “According to them, they have no tools for meeting this requirement. Further, they pointed out that such monitoring is complicated because the Personal Data Protection Act (PDPA) provides that data on officials and persons related to them may be collected and processed only subject to their consent.” Firstly, we would like to highlight that monitoring the use of powers relates, above all, to the constitutional principle of proportionality rather than the protection of personal data.

The General Data Protection Regulation (GDPR) was transposed into Estonian legislation with a view to the concept that public authorities process personal data by virtue of legislative or enforcement provisions rather than act on the basis of an individual's consent. The new PDPA entered into force on 15 January 2019 and amendments to specific legislation on 15 March 2019 but it has little relevance in this context. This is because matters related to the verification of officials’ declarations of interest are governed by the ACA which does not require an individual's consent to conduct such verification.

The audit report does not specify any particular provisions in the wording of the PDPA that was in force until 14 January 2019 or how such provisions would be connected to the ACA. As for declarations of interest, the relevant legal instrument is the ACA that governs everything related to officials’ obligations and their declarations of interest. In principle, we have maintained that the data of individuals related to officials should not be processed without their knowledge unless otherwise provided for by the law (for instance, declarations of interest must contain particulars of the declarer's close ones but the particulars will not be disclosed to the public). Therefore, legislative amendments are required to authorise the agency employing the official to process the particulars of individuals related to that official. A more thorough analysis should be carried out to determine the scope and nature of such authority.

We are aware that officials who are not defined as such for the purposes of the Public Service Act (PSA) are not required to report their ancillary activities or comply with public service ethics rules set out in the PSA. This loophole can be circumvented by means of internal rules and contractual obligations but we recommend making the PSA ethics rules mandatory for all individuals authorised to make decisions in the course of performing public functions, and requiring them to report to their employer any ancillary activities that could potentially compromise the general duties of officials.

However, we would like to underline that currently we see officials themselves as persons responsible for avoiding conflicts of interest in line with the ACA because they need to make sure that they do not knowingly violate any procedural restrictions. In doing so officials rely on their knowledge of their own interests and the known interests of related parties. Agencies may identify and assess conflicts of interest and make relevant adjustments in their work arrangements but this does not relieve officials form their responsibilities. Putting greater focus on institutional monitoring entails the risk that the officials' awareness of and responsibility for compliance becomes secondary and institutional control increases disproportionately - and this is not compatible with our current principles of governance based on openness and trust.

Monitoring compliance with officials' restrictions on activities and procedural restrictions is the responsibility of officials themselves and government agencies whereby each of them will choose the proper methods based on the agency's size, functions and risks. Just like corruption risks and their assessment depend largely on the institutional characteristics, the most effective and proportionate solution for compliance monitoring varies across agencies and taking initiative away from them would reduce their responsibility for implementing anti-corruption policies and measures. Therefore, each agency needs to identify compliance monitoring methods that best suit their own needs. We would like to reiterate that the Ministry of Justice aims to work with internal auditors within the anti-corruption network for liaison officers to collect best compliance monitoring practices and discuss appropriate and common approaches whilst keeping an open mind insofar as the legislative framework allows. Where necessary the best practices can be consolidated into a summary that contains institutional examples of monitoring practices. It is worth noting that developing detailed guidelines, however, would formalise the process and limit the agencies' scope of action and flexibility and, in turn, their responsibility.

As for developing a technological solution for registering persons related to officials, it should be kept in mind that the Estonian system has been intentionally built on public data and the responsibility and awareness of agencies and officials. Hence, we do not find the idea of developing a technological solution for registering persons related to officials well-reasoned or justified as the system in place for declarations of interest serves this purpose already, plus information on connections between persons are available from national registers - some of which are public.

Secondly, building resource-intensive monitoring systems with questionable benefits is not feasible in Estonia. We believe that the Riigiraha (public money) Application should allow improved monitoring of the use of public funds in the future. The Ministry of Finance has promised that additional funding for building a new information system (provided that the old system will not be able to handle additional data loads) or developing an extension for the current Balance Records Information System would be available in 2020-2021. The Centre of State Support Services (CSSS) which is governed by the Ministry of Finance plans to coordinate the draft Public Sector Financial Accounting and Reporting Guidelines with general government bodies by the end of 2019 and prepare a public tender so that work could begin as soon as funding is received. Once we have the required data available, they must be made accessible to the public in the most user-friendly manner possible. The best user interface for presenting transactions between the public sector and private sector is the Opener application (currently in the prototype phase) that is based on open data and developed under the leadership of Transparency International Estonia - an NGO - to improve transparency in terms of connections between public tenders, businesses and political positions. The Ministry of Justice and Transparency International Estonia are currently working together to further develop Opener for which the latter seeks funding.

Comment from the NAO: Paragraph 78 addresses the obligation mentioned in § 3(3)(2) of the Anti-corruption Act. As for the Personal Data Protection Act (in force until 14 January 2019), reference is made to § 6(4) and § 10(1).

The NAO agrees with the Ministry of Justice's proposal to summarise the best practices and develop a user interface for presenting transactions between the public sector and private sector. The NAO will look into this in the following audits.

The possibility and practicability of verifying declarations of interest have not been analysed

Declaration of interest

Declaration of interest - declaration for disclosing information about a person's property and other circumstances for the purpose of recognising interests that could affect the performance of duties.

79. As for the Ministries and the Government Office, the Ministers, Secretaries General and the Secretary of State are required to submit declarations of interest that are examined by a Select Committee of the Riigikogu. In addition to the list provided for by the Anti-corruption Act, government agencies may extend the list to include further declarers like officials who are authorised to administer public assets or conduct offence or administrative proceedings.

80. This may be done only if more effective means for managing corruption risks are not available. Most Ministries and the Government Office have already done so. Three Ministries have not compiled extended lists even though two of them have considered doing so but have found it unjustified.

Pre-filled declarations of interest are obtained automatically as the declarations are interfaced with various databases. For example, information on the declarer's spouse, parents and children originates from the Population Register, information on dividends paid to the declarer from the Tax and Customs Board, information on immovable property from the Land Register, information on vehicles from the Traffic Register, and information on shareholdings from the Commercial Register.

81. Agencies may verify declarations of interest but have normally not done so or failed to document the verification process. The agencies did not consider it necessary to verify pre-filled declarations of interest. They pointed out that they do not have adequate means to verify the completeness and accuracy of submitted data. Hence, the primary goal was to verify whether the declaration has been filed. Any information provided in the declaration is reviewed only insofar as necessary or if there are legitimate interests or suspicions.

82. Given that the material part of the declarer's information is included in the declaration automatically and keeping in mind personal data protection requirements, the NAO finds that the Ministry of Justice should analyse the practicability of substantive review of declarations of interest.

83. **NAO recommendation to the Minister of Justice:** analyse the practicability of verifying declarations of interest and the impact of the provisions of the Personal Data Protection Act in the context of the right to verify declarations of interest.

Response from the Ministry of Justice: In view of the context of processing personal data, the recommendation is basically summed up in a single sentence: "Given that the material part of the declarer's information is included in the declaration automatically and keeping in mind personal data protection requirements, the NAO finds that the Ministry of Justice should analyse the practicability of substantive review of declarations of interest." (paragraph 82). The auditors have not specified the personal data protection requirements that would be relevant in this context. And paragraphs 79 through 82 do not provide any clarification here

We would like to reiterate that the Estonian system of declaring interests is built on public disclosure and institutional self-regulation and that this approach has proven itself to date, especially compared to the clumsy and inefficient system stemming from the previous Anti-corruption Act (ACA) and the costly monitoring systems of some other countries. According to the corruption level index compiled by Transparency International, Estonia is ranked 18th globally and has continued to improve its position without setting up expensive monitoring systems. If each agency verifies declarations of interest on its own it will determine the level of priority and the resources to be used for this based on its corruption risk assessment. This way, agencies take responsibility for the transparency of their operations.

Information inserted in the declaration from other databases usually needs no additional verification, however, the potential impact of the officials' interests manifested by such information on the performance of their functions should be analysed. Information that is not featured in other databases can be reviewed in terms of the impact of underlying interests but, at least in some cases, determining the accuracy of said information is complicated, for example, if it pertains to property abroad or shareholdings in foreign companies. Another option is comparing declarations filed by the same declarer.

Contrary to the argument in the audit report that agencies lack adequate means to verify declarations it should be noted that agencies are authorised to carry out monitoring, require explanations, submit queries, receive information and so on (ACA § 15(6)) - the Ministry of Justice can raise awareness of such authority through the anti-corruption network for liaison officers. Essentially, it means that entities verifying declarations may collect data for specific purposes and in view of the principle of proportionality regardless of the data subject’s consent.

Although § 15(6) of the ACA provides entities conducting the verification with broad discretion to request and compare data, it is evident instead of recommending an all-out inspection we should focus on the important pieces of information in conjunction with the declarer's corruption risks. Also, sample checks can be conducted from time to time, for example, to cover certain types of information across all filed declarations. As a rule, information in declarations of interest is publicly available to identified viewers but some data like the declarer's place of residence or close ones can be accessed only by entities reviewing the declaration. As the statutory requirement to disclose said information only applies to a limited number of officials, the active usage period of the declaration is short, and measures to process the information to a limited extent have been implemented, the Ministry of Justice finds that such processing of data is in line with the principles of personal data protection.

Comment from the NAO: The NAO agrees that verifications should be in line with the intended purpose and proportionality. Nevertheless, the NAO points out that § 15(6) of the Anti-corruption Act provides for the right to verify data in declarations of interest only but declarations might not feature all connections. However, due to the aforementioned provision of the Personal Data Protection Act, entities reviewing the declarations are not authorised to identify the missing connections.

Disclosure of transactions with related parties

There are no effective means to identify transactions subject to disclosure

84. The Public Sector Financial Accounting and Reporting Guidelines (“General Rules”) provide that annual accounts of the state shall disclose information on transactions with related parties that are not in line with the legislation or the general requirements of the accounting entity's internal documents, or the market situation.

85. The Ministries and the Government Office have identified related parties in their accounting policies and procedures. These include, as a minimum, Ministers, State Secretary, Secretaries General and Deputy Secretaries General, and their family members, including but not limited to spouses, unmarried partners and children. In some cases, heads of divisions and their family members are also identified as related parties. The NAO believes that the identification of related parties should be linked to the assessment of corruption risks related to job positions and activities, and rely on the results of risk analysis.

86. The wording of the General Rules has usually been duplicated to comply with the obligation set out therein. Accordingly, persons who draw up, approve or endorse documents relating to transactions are responsible for collecting information on transactions with related parties. The said persons are tasked with supplementing the documentation on transactions subject to disclosure with a notation that the transactions involve~~s~~ related parties.

87. Five Ministries require the members of their highest supervisory body and management to file annual statements where they declare whether or not they have entered into transactions with related parties. The Ministries highlighted as a weakness of this solution that the persons filing statements may not know whether transactions have been made with parties related to them, or they consider the search for transaction information too burdensome and decide not to provide it. Therefore, the information in statements might not be reliable.

88. In its audit reports as well as in its opinion on the regulation amending the General Rules, the NAO has suggested that the regulation be amended so that the annual accounts would disclose all transactions which are not universally offered to everyone on the basis of a price list or legislative provision. This includes aid amounts to related parties there were granted following a public call for proposals, and transactions resulting from a public tender. The NAO finds that amending the regulation would increase transparency and reduce the administrative burden related to the identification of transactions subject to disclosure and requesting statements from related parties.

89. **NAO recommendation to the Minister of Finance and the Minister of Public Administration:** amend the Public Sector Financial Accounting and Reporting Guidelines so that the annual accounts of the state would disclose all transactions which are not universally offered to everyone on the basis of a price list or legislative provision.

Response from the Minister of Finance and the Minister of Public Administration: The Centre of State Support Services (CSSS) has repeatedly discussed improving disclosure of transactions involving related parties with the Ministries' internal auditors. The CSSS has not been able to come up with a solution - for disclosing all transactions which are not universally offered to everyone on the basis of a price list or legislative provision - that could be implemented with reasonable effort in view of all the applicable legal instruments. Collecting such information would be highly labour-intensive and disclosing aggregate amounts would not yield any added value to the annual accounts.

The CSSS intends to further develop the Balance Records Information System to start collecting payment records too. Payment records would feature all payments made by government sector entities, including payment date, amount, payment details, and recipient's name and registration number. If such information is disclosed, everyone interested would be able to find out whom the government sector entities have made payments.

We have talked to the Ministry of Justice about the possibility of developing an interface with the Commercial Register to allow submitting queries - about the payments of reporting entities - to organisations with which the heads of government sector entities are associated either in a managerial capacity or as shareholders.

The CSSS intends to complete the further development of the Balance Records Information System in 2020-2021 and prepare and submit for approval already this autumn the relevant provisions on requirements to payment records that are to be included in the General Rules.

/signed digitally/

Janar Holm
Auditor General

NAO recommendations and replies from the audited entities

In the light of the audit, the NAO made several recommendations to the Ministry of Finance and the Ministry of Justice. The Minister of Finance, the Minister of Public Administration, and the Secretary General of the Ministry of Justice responded to NAO recommendations on 26 August 2019.

General comments from the Ministry of Finance on the audit report
We would like to thank the NAO for their work and constructive cooperation. The audit report highlights areas in managing public finances that need improvement and we will take these into account in our future development efforts.

NAO recommendations	Replies from audited entities
Planning of non-monetary expenses in the state budget **12. Recommendation to the Minister of Finance and the Minister of Public Administration:** envisage non-monetary expenses of notable amount in the state budget to ensure comparability between the budget and its implementation. **(paragraphs 7 to 11)**	**Response from the Minister of Finance and the Minister of Public Administration:** The issue of recognising non-monetary expenses in the state budget is continues to be topical for the Ministry of Finance and we should propose an appropriate solution. Unfortunately, in conjunction with the transition to activity-based budgeting and the related workload we have been unable to analyse this issue thoroughly enough in the context of SBS 2020-2023. Therefore, SBS 2020-2023 was drafted using the old accounting principles (for example, long-term pension commitments are still recognised in human resource accounting). We are currently working to lay down and implement revised accounting principles starting from SBS 2021-2024. We take this matter into account in developing the legal framework of the state budget, incl. in the process of amending the State Budget Act.
Accrual-based budgeting **22. Recommendations to the Minister of Finance:** ▪ explain the principles of accrual-based budgeting to agencies in coordination with the government area's budget managers so as to ensure the accuracy of data supplied in budget implementation reports; ▪ ensure that government areas include all their expenses in the budget. **(paragraphs 13 to 21)**	**Response from the Minister of Finance**: We agree and undertake to explain the principles of accrual-based budgeting to agencies, including at the meetings of the network of finance managers. As for now, we have considered it reasonable to recognise the adjustments caused by the transition to accrual-based budgeting in the targeted reserve fund in view of earlier decisions, and explained the reasoning behind this to the NAO in the framework of the audit report on the accuracy of Annual Accounts 2017 and regularity of transactions of the state. However, we agree that there is a need to conduct further analysis in the course of preparing the SBS 2021-2024 to determine whether it would more practical to recognise the adjustments caused by the transition to accrual-based budgeting in the budgets of respective government areas.
Policies for managing reserve funds **41. Recommendations to the Minister of Finance and the Minister of Public Administration:** ▪ devise principles for determining the optimal size of the Stabilisation Reserve Fund and regulate the calculation methods, assess the nature and amount of any emergency expenditure, and ensure the availability of sufficient reserves; ▪ initiate the amendment of the Estonian Health Insurance Fund Act and the Unemployment Insurance Act to legitimise the use of EHIF/EUIF money for the government's liquidity management; ▪ manage the legal reserves of EHIF/EUIF that have been set up to mitigate risks from macroeconomic changes in line with the same principles as the SRF. **(paragraphs 23 to 40)**	**Response from the Minister of Finance and the Minister of Public Administration**: The Ministry of Finance (MF) finds that the applicable practice for increasing the Stabilisation Reserve Fund (SRF) is adequate and there is no need to set an additional ceiling for the size of the SRF. The SRF grows mostly on the account of cash flow surplus, profit allocations from the Bank of Estonia, and other irregular revenue. Boosting the reserve on the account of current revenue would mean using the cash flow surplus to withdraw additional funds from the economy which would excessively compromise economic growth. The SRF is an important tool for managing crises and emergencies and its symbolic value is to show that the state is ready for crises. However, in crisis situations, the MF cannot rely solely on the SRF because, firstly, it is extremely difficult to estimate the likelihood of various crises (natural disaster, economic crisis, financial crisis, war) and the level of ensuing expenditure. Secondly, in addition to deploying the SRF, the state can take a loan, cut costs or postpone investments in order to manage the crisis. Nevertheless, prevention of crises and more effective risk management are paramount. The SRF will be deployed only in emergencies. The MF aims to ensure that the state's risks are managed in a way that allows the state to finance its commitments in crisis situations without having to resort to the SRF or so that its deployment is postponed for as long as possible. For example, in a crisis, the state can address international crisis management funds (ESM, IMF) or other countries to borrow money. The SRF was last deployed in 2009 when 224 million euros were withdrawn to mitigate macroeconomic risks resulting from the global economic crisis. Also,

NAO recommendations	Replies from audited entities
	two negative supplementary budgets were drawn up in 2009 to cut state budget expenditure by 584 million euros. Back then, IMF's assistance was not needed and the ESM did not exist yet. This demonstrates that deployment of reserves is not the only or primary tool for crisis management. Just as in previous years, the MF continues to maintain that § 39 (1) of the Estonian Health Insurance Fund Act and § 341 (1) of the Unemployment Insurance Act clearly provide that a deposit agreement shall be entered into between the government and EHIF/EUIF. The Riigikogu has authorised the use of the money according to § 67 (2) of the State Budget Act which stipulates that the government may use the deposited money provided that the owners of the money can make payments on account of their money any time. Based on the recommendations from the NAO we have asked the Ministry of Social Affairs to amend the Estonian Health Insurance Fund Act and the Unemployment Insurance Act as both of these Acts concern their government area (Legislative Drafts Information System, file No. 18-0795). The MF points out that the Riigikogu assembled all the funds of the EHIF and the EUIF to be centrally managed by the Ministry of Finance in view of the following policies: 1. Improve the management of cash flows and debt commitments in the public sector because: a) harmonised cash flow management and higher liquidity ensures more efficient use of the state's available financial resources; b) harmonised conservative investment policies yield cost savings for EHIF/EUIF, and the entire state budget. 2. The MF ensures liquidity of the funds of EHIF/EUIF and any investment losses will not be attributed to them. Further, the EHIF/EUIF need no longer pay for costs related to bank transfers and investment operations. At the time of deciding this, the Riigikogu argued that the positive effect of harmonised cash flow management on the state budget and the EHIF/EUIF outweighs the assumption of increased financial risk ensuing from the presumably longer period of using the reserves of EHIF/EUIF. Investing part of the legal reserves of EHIF/EUIF according to the same principles as the SRF money has been under consideration for several times but it has not been found that it would be reasonable given the objectives set out in legislative amendments made in 2011. **Comment from the NAO**: The NAO agrees that there is no need to set a ceiling for the size of reserves. The NAO finds that it is necessary to develop a calculation methodology for the Stabilisation Reserve Fund (SRF) to ensure the availability of sufficient reserves. Likewise, the NAO continues to maintain that the legal reserves of EHIF/EUIF should be managed in line with the same principles as the SRF. Similarly to the SRF, the EHIF/EUIF have a statutory obligation to maintain their legal reserves to manage any risks arising from macroeconomic changes.
Duplication of project funding **50. Recommendation to the Minister of Public Administration:** examine the possibility of including the processing of domestic funding applications in the Register of Structural Aid (SFOS) to avoid duplication of funding and manage the risk of fraud. **(paragraphs 42 to 49)**	**Response from the Minister of Public Administration**: We agree with the recommendation as avoiding the duplication of funding is one of the preconditions set by the European Commission for using European structural and investment facilities (specific activities performed by the same target group may be supported from different sources at the same time if this is in line with the principle of budget neutrality or if the European Commission intends to combine the use of various facilities for the same project during the new EU programming period - however, double reimbursement of costs must be prevented). The Ministry of Finance is looking for solutions to address the risk of double reimbursement and considering, among other options, using the SFOS to this end. We are analysing other alternatives to improve the centralised management and availability of information on project funding. Processing all funding applications in the SFOS might not be optimal because the SFOS has been designed to implement specific rules related to granting EU aid. However, we will analyse the harmonisation of criteria for granting of funding and reviewing of applications in the course of drafting the State Budget Strategy and the actual state budget to ensure that all amounts granted from the budget towards project funding are used purposefully and efficiently. We will consider the options available to us as part of the process of developing national strategic planning and financial management in H2 2019 and in 2020.

NAO recommendations	Replies from audited entities
Assessment of corruption risks **65. Recommendation to the Minister of Justice and the Minister of Public Administration:** explain the necessity of corruption risk assessment to agencies and suggest proper practices. **(paragraphs 61 to 64)**	**Response from the Ministry of Justice**: Assessment of corruption risks is essential and reminding the agencies of its necessity is appropriate. We assure that in the context of implementing anti-corruption policies and providing advice related to the Anti-corruption Act we have always pointed out that each agency should, in view of its specific circumstances, identify the corruption risks of officials acting on its behalf or under its supervision and take the corresponding mitigation measures. To this end, agencies need to map their activity areas and processes and job positions that are susceptible to corruption. The Ministry of Justice can provide explanations and disseminate the best practices through the anti-corruption network for liaison officers. For instance, in 2019 the Ministry teams up with the internal auditors of other Ministries to assess the corruption risks of Ministers and their political advisers. The Ministry expects the NAO to detail on its recommendation to suggest “proper practices” for the assessment of corruption risks. Corruption risk is a type of risk that is assessed in the same way as other types of risk. In 2013, the Ministry of Finance developed risk management guidelines titled “Risk management” that might need revision and updating but the principles therein are applicable today. See https://www.rahandusministeerium.ee/et/riigihaldus/organisatsioonide-juhtimiskvaliteedi-arendamine. **Response from the Minister of Public Administration**: We find that the recommendation is relevant and justified. With guidance from the Ministry of Justice we will continue nationwide harmonisation of the methodology for corruption risk assessment and development of the relevant guidelines. The current initiative of the Ministries’ liaison officers for anti-corruption and internal auditors which is led by the Ministry of Justice and aims to map the corruption risks of Ministers and political advisers is an important step here. Centralised training courses on ethics and corruption prevention provided annually by the Ministry of Finance in coordination with the Centre of State Support Services help build the competencies required to assess corruption risks. **Comment from the NAO**: The NAO finds that the Ministry of Justice and the Ministry of Finance should updated the guidelines for corruption risk assessment as they both claim that the guidelines require revision. The NAO intends to monitor the relevant progress on an ongoing basis.
Prevention of corruption risks **70. Recommendation to the Minister of Public Administration:** consider making the statement of independence mandatory for all public tenders and advise contracting entities to introduce relevant measures that do not increase the administrative burden. **(paragraphs 66 to 69)**	**Response from the Minister of Public Administration:** Avoiding conflicts of interest in public tenders has become more topical since 1 September 2017 as the Public Procurement Act (PPA) that entered into force on that date requires contracting entities to set out - in their procurement rules or, failing these, in other internal documents on work arrangements - measures for preventing, identifying and eliminating conflicts of interest related to public procurement. The Ministry of Finance (MF) analyses the conformity of procurement rules with PPA provisions using, among other things, random sampling as part of public procurement monitoring. If there are shortcomings, the contracting entities will receive recommendations and guidelines for adjusting their procurement rules. The MF has addressed prevention of corruption and conflicts of interest in the framework of training sessions held in 2019 (materials publicly available in the self-service portal for government employees). The web site of the MF provides access to a manual titled “Addressing conflicts of interest in public sector” and features a link to the web site korruptsioon.ee where the Ministry of Justice has published a number of relevant guidelines. At the end of 2018, the MF web site published the “Indicative guidelines for designing internal controls in local government bodies” which contains recommendations for avoiding conflicts of interest, including in conjunction with public tenders. The latter guidelines can be used by agencies covered by this audit too. The PPA requires contracting entities to determine appropriate measures for preventing, identifying and eliminating conflicts of interest. Given that contracting entities differ as to their staff number, work flows and procurement practices (for example, making use of centralised procurement services changes procurement practices considerably), we maintain that it would be reasonable to let the entities determine the appropriate measures and their methods of implementation without setting out in the PPA any additional mandatory requirements that

NAO recommendations	Replies from audited entities
	would apply universally to all contracting entities. The MF supports cutting red tape meaning that any additional mandatory requirements to contracting entities should be strictly necessary. We would like to point out that the statement of no conflict of interest related to the public tender can be included in documents like reports or decisions drawn up by the contracting entity. Even though the documents automatically drafted by the Public Procurement Register (PPR) do not contain this statement as of now, contracting entities are free to add it. Further, in the PPR the contracting entities can add to each public tender internal documents like a statement of no conflict of interests by a person related to the preparation or implementation of the tender process. In conclusion, we find that the MF can continue to support the avoidance of conflicts of interest in public tenders by counselling and monitoring contracting entities and, insofar as practicable, adding the relevant tool in the PPR to help contracting entities without increasing their workload. **Comment from the NAO**: The NAO supports the Ministry of Finance's idea to add a relevant tool in the Public Procurement Register that helps contracting entities avoid conflicts of interest. The NAO will plan activities to analyse its introduction in the next audit.
Compliance monitoring **78. Recommendations to the Minister of Justice:** ▪ assess the impact of the provisions of the Personal Data Protection Act on the monitoring of compliance with obligations set out in the Anti-corruption Act, and develop a solution that allows complying with both said Acts; ▪ develop guidelines for monitoring the compliance of officials with their obligations; ▪ in coordination with the Ministry of Finance, develop a technological solution for registering persons associated with officials. **(paragraphs 71 to 77)**	**Response from the Ministry of Justice**: You have recommended that the Ministry of Justice should assess the impact of the provisions of the Personal Data Protection Act (PDPA) on compliance monitoring (the NAO has failed to specify the obligations in paragraph 78; we assume that these are obligations set out in § 3(3)(2) of the Anti-corruption Act (ACA)) and noted: "According to them, they have no tools for meeting this requirement. Further, they pointed out that such monitoring is complicated because the Personal Data Protection Act (PDPA) provides that data on officials and persons related to them may be collected and processed only subject to their consent." Firstly, we would like to highlight that monitoring the use of powers relates, above all, to the constitutional principle of proportionality rather than the protection of personal data. The General Data Protection Regulation (GDPR) was transposed into Estonian legislation with a view to the concept that public authorities process personal data by virtue of legislative or enforcement provisions rather than act on the basis of an individual's consent. The new PDPA entered into force on 15 January 2019 and amendments to specific legislation on 15 March 2019 but it has little relevance in this context. This is because matters related to the verification of officials' declarations of interest are governed by the ACA which does not require an individual's consent to conduct such verification. The audit report does not specify any particular provisions in the wording of the PDPA that was in force until 14 January 2019 or how such provisions would be connected to the ACA. As for declarations of interest, the relevant legal instrument is the ACA that governs everything related to officials' obligations and their declarations of interest. In principle, we have maintained that the data of individuals related to officials should not be processed without their knowledge unless otherwise provided for by the law (for instance, declarations of interest must contain particulars of the declarer's close ones but the particulars will not be disclosed to the public). Therefore, legislative amendments are required to authorise the agency employing the official to process the particulars of individuals related to that official. A more thorough analysis should be carried out to determine the scope and nature of such authority. We are aware that officials who are not defined as such for the purposes of the Public Service Act (PSA) are not required to report their ancillary activities or comply with public service ethics rules set out in the PSA. This loophole can be circumvented by means of internal rules and contractual obligations but we recommend making the PSA ethics rules mandatory for all individuals authorised to make decisions in the course of performing public functions, and requiring them to report to their employer any ancillary activities that could potentially compromise the general duties of officials. However, we would like to underline that currently we see officials themselves as persons responsible for avoiding conflicts of interest in line with the ACA because they need to make sure that they do not to knowingly violate any procedural restrictions. In doing so officials rely on their knowledge of their own interests and the known interests of related parties. Agencies may identify and assess conflicts of interest and make relevant

NAO recommendations	Replies from audited entities
	adjustments in their work arrangements but this does not relieve officials form their responsibilities. Putting greater focus on institutional monitoring entails the risk that the officials' awareness of and responsibility for compliance becomes secondary and institutional control increases disproportionately - and this is not compatible with our current principles of governance based on openness and trust. Monitoring compliance with officials' restrictions on activities and procedural restrictions is the responsibility of officials themselves and government agencies whereby each of them will choose the proper methods based on the agency's size, functions and risks. Just like corruption risks and their assessment depend largely on the institutional characteristics, the most effective and proportionate solution for compliance monitoring varies across agencies and taking initiative away from them would reduce their responsibility for implementing anti-corruption policies and measures. Therefore, each agency needs to identify compliance monitoring methods that best suit their own needs. We would like to reiterate that the Ministry of Justice aims to work with internal auditors within the anti-corruption network for liaison officers to collect best compliance monitoring practices and discuss appropriate and common approaches whilst keeping an open mind insofar as the legislative framework allows. Where necessary the best practices can be consolidated into a summary that contains institutional examples of monitoring practices. It is worth noting that developing detailed guidelines, however, would formalise the process and limit the agencies' scope of action and flexibility and, in turn, their responsibility. As for developing a technological solution for registering persons related to officials, it should be kept in mind that the Estonian system has been intentionally built on public data and the responsibility and awareness of agencies and officials. Hence, we do not find the idea of developing a technological solution for registering persons related to officials well-reasoned or justified as the system in place for declarations of interest serves this purpose already, plus information on connections between persons are available from national registers - some of which are public. Secondly, building resource-intensive monitoring systems with questionable benefits is not feasible in Estonia. We believe that the public money application should allow improved monitoring of the use of public funds in the future. The Ministry of Finance has promised that additional funding for building a new information system (provided that the old system will not be able to handle additional data loads) or developing an extension for the current Balance Records Information System would be available in 2020-2021. The Centre of State Support Services (CSSS) which is governed by the Ministry of Finance plans to coordinate the draft Public Sector Financial Accounting and Reporting Guidelines with general government bodies by the end of 2019 and prepare a public tender so that work could begin as soon as funding is received. Once we have the required date are available, they must be made accessible to the public in the most user-friendly manner possible. The best user interface for presenting transactions between the public sector and private sector is the Opener application (currently in the prototype phase) that is based on open data and developed under the leadership of Transparency International Estonia - an NGO - to improve transparency in terms of connections between public tenders, businesses and political positions. The Ministry of Justice and Transparency International Estonia are currently working together to further develop Opener for which the latter seeks funding. **Comment from the NAO**: Paragraph 78 addresses the obligation mentioned in § 3(3)(2) of the Anti-corruption Act. As for the Personal Data Protection Act (in force until 14 January 2019), reference is made to § 6(4) and § 10(1). The NAO agrees with the Ministry of Justice's proposal to summarise the best practices and develop a user interface for presenting transactions between the public sector and private sector. The NAO will look into this in the following audits.
Declaration of interest **83. Recommendation to the Minister of Justice:** analyse the practicability of verifying declarations of interest and the impact of the provisions of the Personal Data Protection Act in the context of the right to verify declarations of interest.	**Response from the Ministry of Justice**: In view of the context of processing personal data, the recommendation is basically summed up in a single sentence: "Given that the material part of the declarer's information is included in the declaration automatically and keeping in mind personal data protection requirements, the NAO finds that the Ministry of Justice should analyse the practicability of substantive review of declarations of interest." (paragraph 82). The auditors have not specified the personal data protection

NAO recommendations	Replies from audited entities
(paragraphs 79 to 82)	requirements that would be relevant in this context. And paragraphs 79 through 82 do not provide any clarification here. We would like to reiterate that the Estonian system of declaring interests is built on public disclosure and institutional self-regulation and that this approach has proven itself to date, especially compared to the clumsy and inefficient system stemming from the previous Anti-corruption Act (ACA) and the costly monitoring systems of some other countries. According to the corruption level index compiled by Transparency International, Estonia is ranked 18th globally and has continued to improve its position without setting up expensive monitoring systems. If each agency verifies declarations of interest on its own it will determine the level of priority and the resources to be used for this based on its corruption risk assessment. This way, agencies take responsibility for the transparency of their operations. Information inserted in the declaration from other databases usually needs no additional verification, however, the potential impact of the officials' interests manifested by such information on the performance of their functions should be analysed. Information that is not featured in other databases can be reviewed in terms of the impact of underlying interests but, at least in some cases, determining the accuracy of said information is complicated, for example, if it pertains to property abroad or shareholdings in foreign companies. Another option is comparing declarations filed by the same declarer. Contrary to the argument in the audit report that agencies lack adequate means to verify declarations it should be noted that agencies are authorised to carry out monitoring, require explanations, submit queries, receive information and so on (ACA § 15(6)) - the Ministry of Justice can raise awareness of such authority through the anti-corruption network for liaison officers. Essentially, it means that entities verifying declarations may collect data for specific purposes and in view of the principle of proportionality regardless of the data subject's consent. Although § 15(6) of the ACA provides entities conducting the verification with broad discretion to request and compare data, it is evident instead of recommending an all-out inspection we should focus on the important pieces of information in conjunction with the declarer's corruption risks. Also, sample checks can be conducted from time to time, for example, to cover certain types of information across all filed declarations. As a rule, information in declarations of interest is publicly available to identified viewers but some data like the declarer's place of residence or close ones can be accessed only by entities reviewing the declaration. As the statutory requirement to disclose said information only applies to a limited number of officials, the active usage period of the declaration is short, and measures to process the information to a limited extent have been implemented, the Ministry of Justice finds that such processing of data is in line with the principles of personal data protection. **Comment from the NAO**: The NAO agrees that verifications should be in line with the intended purpose and proportionality. Nevertheless, the NAO points out that § 15(6) of the Anti-corruption Act provides for the right to verify data in declarations of interest only but declarations might not feature all connections. However, due to the aforementioned provision of the Personal Data Protection Act, entities reviewing the declarations are not authorised to identify the missing connections.
Transactions with related parties **89. Recommendation to the Minister of Finance and the Minister of Public Administration:** amend the Public Sector Financial Accounting and Reporting Guidelines so that the annual accounts of the state would disclose all transactions which are not universally offered to everyone on the basis of a price list or legislative provision. **(paragraphs 84 to 88)**	**Response from the Minister of Finance and the Minister of Public Administration:** The Centre of State Support Services (CSSS) has repeatedly discussed improving disclosure of transactions involving related parties with the Ministries' internal auditors. The CSSS has not been able to come up with a solution - for disclosing all transactions which are not universally offered to everyone on the basis of a price list or legislative provision - that could be implemented with reasonable effort in view of all the applicable legal instruments. Collecting such information would be highly labour-intensive and disclosing aggregate amounts would not yield any added value to the annual accounts. The CSSS intends to further develop the Balance Records Information System to start collecting payment records too. Payment records would feature all payments made by government sector entities, including payment date, amount, payment details, and recipient's name and registration number. If such information is disclosed, everyone interested would be able to find out whom the government sector entities have made payments. We have talked to the Ministry of Justice about

NAO recommendations	Replies from audited entities
	the possibility of developing an interface with the Commercial Register to allow submitting queries - about the payments of reporting entities - to organisations with which the heads of government sector entities are associated either in a managerial capacity or as shareholders. The CSSS intends to complete the further development of the Balance Records Information System in 2020-2021 and prepare and submit for approval already this autumn the relevant provisions on requirements to payment records that are to be included in the General Rules.

Overview of the Consolidated Annual Report

The Consolidated Annual Report of the State has been prepared pursuant to the State Budget Act and Estonian financial reporting standards. The Consolidated Annual Report of the State comprises the state's annual accounts with the State Budget Implementation Report (i.e. the state's consolidated and unconsolidated report), additional information about local governments, the public sector and the government sector, and the management report.

The financial data of 17 state accounting entities, incl. agencies in their areas of government, the State Forest Management Centre, 58 state-controlled foundations and 27 state-controlled companies are consolidated in the consolidated annual accounts of the state. Additional information is given about 79 local authorities, and the indicators of the foundations, non-profit organisations and subsidiaries under their control are also included. On top of the above, information about the government sector and public sector also contains legal entities in public law and entities under their direct or indirect control.

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

Description of audit

Audit objective

The State Budget Act requires the NAO to audit the annual accounts of the state. Likewise, the NAO is required to audit the regularity of transactions conducted by the state.

The objective of the audit is to provide an opinion on the Annual Accounts 2018 and the regularity of transactions of the state. The Annual Accounts of the State contain the balance sheet of consolidated and unconsolidated assets and liabilities as at 31/12/2018, the consolidated and unconsolidated income statement, report on changes in net assets and cash flow statement for the financial year ended on 31/12/2018, a summary of the accounting policies and procedures used in preparing the annual accounts and other explanatory notes. The annual accounts contain the State Budget Implementation Report as a supplementary statement.

Principles for expressing an opinion

Providing an opinion on the accuracy of the annual accounts of the state and the regularity of transactions means that:

- the annual accounts are accurate if they are prepared pursuant to Estonian financial reporting standards, and all material information which provides a fair presentation of the financial position of the state has been made public;
- transactions are legitimate if performed in compliance with the State Budget Act, the 2018 State Budget Act and the 2018 State Budget Act Amendment Act.

Audit scope

In order to provide an opinion on the accuracy of the state's annual accounts, the NAO assessed the conformity of the annual accounts with Estonian financial reporting standards. The main requirements of these principles are set out in the Estonian Accounting Act, which is supplemented by the guidelines of the Accounting Standards Board and the Public Sector Financial Accounting and Reporting Guidelines. Estonian financial reporting standards are based on internationally recognised accounting policies (EU directives on accountancy, International Public Sector Accounting Standards).

Auditing of compliance with State Budget Acts is divided into two segments: auditing the regularity of transactions and auditing the budget implementation report. In order to express an opinion on the regularity of transactions, the NAO audited whether or not the transactions were performed in accordance with the State Budget Act, the 2018 State Budget Act and the 2018 State Budget Act Amendment Act in all material respects. To this end, the NAO examined whether: state budget revenues had been collected; expenses, investments and financing operations were effected expediently; and the budget adopted with the annual state budget act and budget amendments have been respected.

Further, the NAO examined whether state agencies assumed commitments only when funds were allocated to them for this end in the state budget and whether all revenues, expenses, investments and financing operations have been broken down in a manner that clearly determines their financial nature or purpose. In the context of auditing the budget implementation report, the NAO examined whether the report was drawn up in accordance with the budget breakdown and whether any adjustments were justified.

Limitation of scope

The NAO does not provide an opinion on the management report presented as part of the Consolidated Annual Report of the State. The numerical values in the management report originating directly from the annual accounts were checked. The NAO did not carry out audit procedures to check additional information (annual accounts) about local authorities, the public sector or the government sector disclosed in the Consolidated Annual Report of the State.

Audit approach

The NAO carried out the audit in accordance with INTOSAI (International Organisation of Supreme Audit Institutions) auditing standards which address the auditing of financial statements and the legality of transactions in the framework of an audit of financial statements. These standards require that an audit be planned and performed in a manner that allows the auditor to decide with reasonable assurance that the financial statements are free of any material misstatements and that transactions, insofar as audited, comply with the State Budget Act, the 2018 State Budget Act and the 2016 State Budget Act Amendment Act in all material respects.

During the audit, evidence was collected on the numerical values and other information disclosed in financial statements and on the regularity of transactions. To facilitate the planning of appropriate audit operations, the NAO took into account the internal control system put in place for drawing up financial statements and ensuring the regularity of transactions. The NAO does not issue an opinion on the effectiveness of internal controls on the whole. Also, the auditors examined whether the applied accounting policies were relevant and any accounting estimates by the management were justified.

The NAO is of the opinion that the audit provides a sufficient basis for expressing an opinion on the accuracy of the annual accounts, the reliability of the state budget implementation report and the regularity of transactions.

Time of completing the audit

The audit was completed in July 2019.

Audit team

The audit involved auditors from the Audit Department and was managed by Audit Manager Angela Onno.

Contact particulars

For further information on the audit, please contact the NAO Communication Unit by
phone: +372 640 0704 or +372 640 0777, or e-mail: riigikontroll@riigikontroll.ee.

The electronic version of the audit report (pdf) is available on web site www.riigikontroll.ee.
The summary of the audit report is available in English also.
The reference number of the audit report in the NAO records system is 2-1/80018/24.

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NAO's earlier audits on the consolidated annual report of the state

29 August 2018 – **Accuracy of Annual Accounts 2017 and regularity of transactions of the state**

28 July 2017 – **Accuracy of Annual Accounts 2016 and regularity of transactions of the state**

29 August 2016 – **Accuracy of Annual Accounts 2015 and regularity of transactions of the state**

19 August 2015 – **Accuracy of consolidated annual report 2014 and regularity of transactions of the state**

12 August 2014 – **Accuracy of consolidated annual report 2013 and regularity of transactions of the state**

15 August 2013 – **Accuracy of consolidated annual report 2012 and regularity of transactions of the state**

All reports are available on the NAO web site www.riigikontroll.ee

Annex 1. Audited information systems

Ministry	Name of information system	Accounting data that rely on the system
Ministry of Justice	Land Register	Revenues
Ministry of Justice	Court Information System	Revenues
Ministry of the Environment	Environmental Permits Information System (KLIS)	Revenues
Ministry of Rural Affairs	PRIAX, ARMA (accounting system for decisions and payments), aid, MARSA 2	Benefits and allowances
Ministry of Economic Affairs and Communications	Traffic Register	Revenues
Ministry of Economic Affairs and Communications	Electronic Maritime Information System	Revenues
Ministry of Economic Affairs and Communications	Road Tax Information System	Revenues
Ministry of Finance	Register of Taxable Persons (MKR)	Revenues
Ministry of Finance	SAP (accounting software)	Central reporting system (for financial, personnel and salary accounting)
Ministry of Finance	RTIP (self-service portal for government employees)	Assets, management costs, labour costs
Ministry of Finance	SFOS (Register of Structural Aid)	Benefits and allowances
Ministry of Finance	e-Treasury	Cash at bank and in hand
Ministry of Finance	Balance Records Information System	Central reporting system
Ministry of Finance	Fitek information system for processing purchase invoices	Assets, management costs
Ministry of the Interior	MIS - Information System on Proceedings	Revenues
Ministry of the Interior	ITDAK – Database of Identity Documents	Revenues
Ministry of the Interior	OZZ – Information System on Collection of Government Levies	Revenues
Ministry of Social Affairs	Social Protection Information System	Benefits and allowances
Ministry of Foreign Affairs	Visa Register	Revenues