



NATIONAL AUDIT
OFFICE OF LITHUANIA

• BRINGING BENEFITS •

ASSESSMENT OF REGULARITY OF 2018 SETS OF STATE CONSOLIDATED FINANCIAL AND BUDGET EXECUTION REPORTS AND LEGALITY OF MANAGEMENT, USE AND DISPOSAL OF STATE BUDGET FUNDS AND PROPERTY

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No. FA-8

SUMMARY

The Objective and Scope of the Audit

Pursuant to Article 134 of the Constitution of the Republic of Lithuania, the Statute of the Seimas, the Law on National Audit Office, the Law on Public Sector Accountability and the Law on the Structure of the Budget, we have conducted the audit of the 2018 set of state consolidated reports and evaluated the legality of state budget funds and management, use and disposal of property in 2018 in areas selected for the audit.

In view of the importance of budgetary governance for a sound and transparent distribution and use of public resources, and in order to provide new insights for the strategic planning and transformation of the budget, during the audit we also assessed whether the result-based budget structure is fostered by a funding model, where programmes, funds and institutions are financed by the part of tax and other income established in advance by law; when assessing activities, financed by these funds, programmes and institutions, we have analysed the data of the I semester of the years 2015-2019. At the same time, we analysed the funding provided by appropriation managers to the project activities where the state budget supports various activities and initiatives, as well as the funding of other entities.

In accordance with the Law on Intelligence¹ we assessed the use of funds by criminal intelligence entities in 2018 within the scope of this audit. The results of the audit procedures,² after designation of security classification in accordance with legislation, have been submitted to the Commission for Parliamentary Scrutiny of Criminal Intelligence of the Seimas of the Republic of Lithuania.

The audit was conducted in accordance with the Public Auditing Requirements, International Standards on Auditing and International Standards of Supreme Audit Institutions. The audit report contains only the items performed and identified during the audit and the independent opinion on the sets of consolidated financial and budget execution reports is presented in the audit conclusion. The scope and methods of the audit are described in greater detail in Annex 2, Audit Scope and Methods (page 113).

The main results of the Audit

Set of state consolidated financial reports:

1. Centralised accounting processes need to be improved and recommendations for improving their quality have been made

Following initiatives to optimise the system of public sector bodies, the National Centre for General Functions was set up in 2018. In 2018 it provided centralized accounting for 139 institutions. Its activities are coordinated and controlled by the Ministry of Finance. The ongoing accounting consolidation process is a new one with a general information system necessary for this function not yet in place, and it is therefore essential that the institutions provide timely information for keeping records and preparing accounts, to the institution implementing these functions, as well as cooperate in good will. During the audit, we have become familiar with the process of consolidating the accounting function and the internal control system set up by the Centre and made recommendations to the Ministry of Finance and the Centre to improve the quality of these processes. We recommended the Ministry to standardise the business processes, necessary for centralised management of accounting of institutions, to review and update legal acts regulating internal control, and to take steps to ensure that institutions (which have centralised their accounting) properly update their financial control rules. We recommended to the National Centre for General Functions to envisage measures to ensure timely calculation of compensations and settlement with employees, prompt reconciliation and correction of identified accounting errors, and timely preparation of sets of financial and budget execution reports. The institutions have chosen measures to implement the recommendations. It is planned that by 2021, the consolidation of the accounting function of the entire public sector will be implemented, the information systems will be unified, as well as accounting methods and processes will be standardised, which will reduce accounting errors (sub-section 1.1).

2. There are material misstatements in the set of state consolidated financial reports

¹ Law on Intelligence, Article 20 (3): "The use of funds by intelligence institutions shall be controlled by the Auditor General or by officers duly authorized by his order".

² Law on Intelligence, Article 20 (4)

In the year 2018 there are still significant errors and amounts, the correctness of which we were unable to confirm for various reasons.

Due to the circumstances remaining in the audited period (2018), which are related to the deficiencies in the information system used by the State Tax Inspectorate to maintain accounting for the tax fund, we are unable to confirm that a significant portion of state tax revenue (93 percent) and other revenue from main activities (4 percent) and receivables related to them (40 percent), as well as payables (29 percent) are correct in the set of state consolidated financial reports for 2018. In order to remove major system weaknesses by December 2018, the Tax accountancy information system development investment project of the State Tax Inspectorate, which was implemented in the period of 2016-2018, was completed. As of the beginning of 2019, the accounting is processed according to the modified information system.

A significant proportion (57 percent) of movable cultural (museum) values are still recorded at the symbolic value of one euro rather than their real value (at the end of 2018, there were 1 416.7 thousand items in the main funds). It was planned to carry out the evaluation of cultural values by 31 December 2020, however, taking into account the results of the evaluation of recent years (10-13 percent of values have been evaluated in the last two years), the process is not expected to be completed in due time. It may take up to 6 years to evaluate all museum values.

We are unable to approve the correctness of the sum of EUR 505.0 million stated in the set of reports as the value of land (2.4 percent), due to improper accounting of roads land and forests - wrongly registered economic transactions in the transfer-acceptance of land plots, a part of land plots is unrecorded, incorrectly registered or unspecified the fair value of land, improperly performed inventory.

When consolidating the data of the sets of financial reports of public sector entities (over 600), the Ministry of Finance manually corrects the errors made by these entities (the data, which was incorrectly entered into the Public sector accounting and reporting information system). The Ministry does not always find out the causes of errors and therefore corrects them with incorrect manual entries. As a result of their reporting, the balances of certain items are shown to be lower or higher, with significant increases in the net asset value reserve (EUR 6,018.7 million) and collected surplus and deficit (EUR 6 084.4 million) balances.

The situation regarding the accounting of court stamp duty and court fines has not changed so far - the courts continue to not record this income and the National Courts Administration does not plan any action to change the situation. According to data from the State Tax Inspectorate, the state budget for 2018 received EUR 16.5 million stamp duty and fine revenue. The Court financial reports and the set of state consolidated financial reports do not give a true and fair view of the income and related receivables and payables.

In order to ensure the quality of public sector entities reports, it is essential that the consolidated group financial statements are prepared using the same accounting policies for the same economic transactions and events. The 2018 set of consolidated financial reports of the Ministry of Health Care include the financial reports of 36 institutions (17 of which are public entities). We have detected, that there were no general accounting procedures in this group of institutions for certain types of provisions, accounting for

blood and blood components, and found deficiencies in the income accounting practices. The Ministry has already planned measures to implement the recommendations.

The accounting errors detected each year only confirm the importance of the Supreme Audit Institution's³ recommendation to the Ministry of Finance, that all public sector entities should review their activities, assets and liabilities and evaluate whether this is reflected in their financial reports. The impact of the recommendation would be demonstrated by the reduced level of misstatements in the financial reports of public sector entities and the improved quality of consolidated reports (sub-section 1.2).

Set of State budget execution reports:

3. The set of budget execution reports is correct in its essence, but decisions on the exact breakdown of revenue by type are still being sought

We did not detect any essential errors in the 2018 set of state budget execution reports. The issue of accurate disclosure of state revenue by type remains unresolved - the Ministry of Finance continues to use the data of the State Tax Inspectorate tax fund for the set of state budget execution reports, which does not include changes related to the registry of taxpayer declarations, submitted after the final reporting period. The impact of deviations in recent years is not significant (the Inspectorate prepares and submits revised data to the Ministry), however correct data is needed to improve the quality of the set of state budget execution reports (hereinafter - SSBER), important for the calculation of the country's macroeconomic indicators and budgeting for future periods. The final resolution of the problem requires more active actions by the Ministry, therefore, we recommended that it should plan measures to ensure that all and final tax fund accounting records for the reporting period are used to compile SSBER.

Every year we identify cases where public sector entities do not comply with the approved economic classification of revenue and expenditure in the state and municipal budgets and plan and account expenditure in ineligible items in the economic classification of expenditure. Audited entities have attributed EUR 16.3 million of expenditure for improper expenditure economic classification items in 2018. Proper classification of such expenditure would indicate the true purpose of these costs, and would provide objective information for monitoring and analysis of the entity's activities (sub-section 1.3).

Management, use and disposal of state budget funds and property

4. Internal control systems in criminal intelligence entities are generally functioning properly

After completing audit procedures at all major criminal intelligence institutions in 2018, we have not identified any essential deficiencies in the use of funds for this activity or in the essence of functioning of internal control systems. We made recommendations to three entities to improve their created internal controls, to allow timely identification of risks associated with the use of funds for criminal intelligence, and data on spent funds

³ Public audit report "The 2016 assessment of the set of national financial statements and public debt", 29-09-2017 No. FA-2017-P-60-6-8-1.

to ensure their accuracy. We made recommendations to 6 entities to assess the compliance of approved funding arrangements with higher-level legislation and to adopt appropriate amendments in the light of the evaluation results. Information on the results of the audit was provided to the Seimas Committee on Parliamentary Scrutiny of Criminal Intelligence (sub-section 1.4).

5. Employee social security - civil liability insurance, not specified by law, although in practice it is applied by budgetary institutions

We have found cases where budgetary institutions provide employees with social security - civil liability insurance, although the Law on Civil Service and the Internal service statute do not provide for such guarantees to civil servants and officials. In the year 2018 - 6 institutions had such valid contracts. Until a comprehensive evaluation of the liability insurance of public sector employees has been carried out (cost-benefit analysis, efficiency, effectiveness, results and efficiency analysis, etc.), one may not state, that such insurance contracts concluded by public sector institutions with insurers will contribute to the positive and effective management and use of state finances and assets. We recommend that the Government consider the need for such a guarantee and, where appropriate, initiate regulation of such insurance (sub-section 1.3).

6. Control of the use of state budget grants for training needs to be strengthened

Most of the appropriations earmarked for the implementation of programs by the Ministry of Education, Science and Sports (80%, or EUR 652.6 million) were made up of municipal education (training) grants. These funds were distributed to more than 1,000 teachers and other persons involved in education in the country (early, pre-school and general education) to pay their salaries, improve their qualifications, purchase textbooks and other teaching aids. As a result of our audit procedures, in 7 schools, we have identified cases of improper use of grants (in 2 of the schools), which led the municipalities to return the misused funds to the Ministry. We identified shortcomings in the award of employee bonuses in 4 schools due to incorrect application or implementation of the provisions governing the issue of awards. The shortcomings in the schools identified during the audit further justify the need for the Ministry to take a more active role in the implementation of the 2017 recommendation of the Supreme Audit Institution "to create a system of teacher career development and evaluation by encouraging the continuous development of teachers and establishing a link between remuneration and performance and existing competences"⁴. We recommend that the Ministry of Education, Science and Sports should improve its internal controls on grants so that they can identify potential risks related to their transparent, effective and cost-effective use (sub-section 1.4).

Budget governance

7. Essential changes in the strategic planning and budgeting system are expected

The program budgeting in Lithuania is largely in place, however it is not properly oriented towards results, that should ensure positive changes in public life, and reporting does not

⁴ Public Audit Report "Could Lithuanian students perform better", 28-11-2017 No. VA-2017-P-50-1-20.

provide useful information for decision making. Since 2016, the Supreme Audit Institution provides recommendations to the Government to improve budgetary governance in the course of public audits. The government has provided consistent measures for the implementation of recommendations until 2020. A new quality medium-term budget is planned for 2021-2023. We positively assess the Government's determination to reform its strategic planning and budgeting system, but significant changes are still awaited. The recommendations made during the audits concerning strategic planning and reporting on results remain relevant. The draft law amending the Law on the Budget Structure and the Law on Strategic Management are currently under preparation and, in the opinion of the Supreme Audit Institution, they require improvement. As we continue to address budgetary governance issues, we provide the Government with new insights into the ongoing restructuring of strategic planning and budgeting. We believe that restructuring should also address state budgeting issues where, in the absence of negotiations, programmes, funds and institutions are funded through a predetermined proportion of statutory fees and charges, specified in legislation (hereinafter referred to as "fixed funding programmes"), attention is also brought to the financing of project activities and other entities applied by the appropriation managers, of which there is no country-wide data, therefore we have collected them during the audit. The absence of such data complicates budgetary governance (Section 2).

8. The use of fixed funding does not guarantee results-oriented state budgeting

The results of the audit of fixed funding programmes have shown that there are no established objectives and criteria for the application of this type of financing, that the level of fixed funding is not supported by evidence, and that the eligibility of projects selected for funding is not always substantiated. Therefore, the use of fixed funding financing does not encourage results-oriented budgeting and budget execution.

The documents governing the establishment of the 14 fixed funding programmes, assessed during the audit, do not set specific, measurable and time-bound objectives for the programmes. The approval or amendment of the size of these programmes, or their source of financing has never been based on the cost-benefit analysis, need of programme financing has not been justified, no assessment has been carried out on how the programme results will change with the increase or decrease of financing, and (or) no arguments have been provided, why the specific source of financing is chosen. The sum of funds acquired by 14 assessed programmes per year in the period of 2016-2018 has increased by 4.6 percent (EUR 31.1 million), and the amount of unused funds increased by 57 percent (EUR 75.5 million) and amounted to EUR 207.7 million at the end of 2018.⁵

Without having fixed funding application objectives and criteria in place, activities, financed in such a way, do not differ from the activities, financed by the simple budget negotiations, whereas fixed funding programme funds are used for the implementation of permanent functions of the institutions, financing activities, which do not require a special financing model and covering their expenses (paying wages for employees, purchasing goods and services (employee uniforms, souvenirs), zoo and museum maintenance, etc.), are redistributed to finance programmes implemented by other appropriation managers, etc. (section 3.1).

⁵ In assessing the balance of unused funds, the Reserve (Stabilization) Fund, the purpose of which is to accumulate the state's monetary resources necessary to ensure financial stability, has been eliminated.

9. There is a need for general rules for project (selection) funding

Project-base (selection) funding is widely used because the state supports relevant activities, initiatives (sports, culture, agriculture, small business, etc.) by financing them through project-based (selection) funding. The laws regulating the formulation and execution of the state budget do not define such a way of funding. The appropriation managers shall initiate project funding (excluding public procurement procedures) for the implementation of the measures in the ongoing programmes in accordance with their own project/selection procedures. No country-wide data on project funding by public authorities or bodies are collected. According to our collected data, 49 state institutions and bodies have distributed over EUR 174.1 million of state budget funds in 2018, following 141 different financing (selection) procedures. The funds were distributed to 9 654 beneficiaries selected by tender, including non-governmental organizations. We have found that the requirements of the existing funding (selection) procedures for the selection of recipients, establishment of objectives and indicators, reporting for funding, selection and publishing the performance results are deficient or incomplete (unclear), so that the purposefulness of funding is not always supported by evidence. This practice of project-based financing, in the absence of common funding rules, allows for possible biased and opaque use of state budget funds (Section 3.2).

10. Procedures for financing of other entities (non-budgetary institutions) should be reviewed

The Law on the Budget Structure establishes the possibility for the appropriation managers to allocate state budget funds for the implementation of measures of the state budget programmes, without applying the provisions of the Law on Public Procurement, not only to its subordinate institutions but also to other entities, which comply with the conditions stated in the law. According to our collected data, in 2018 there were 18 public authorities/institutions, which applied this funding method and distributed over EUR 133.6 million of budget funds under 130 contracts to 109 other entities. Four cases of unlawful financing of other entities have been identified. Meanwhile, the practice of financing non-subordinate budgetary institutions as other entities is flawed according to strategic planning. We consider that planning of the state budget funding by the appropriation managers, who is not subordinate to the budgetary institution, in the strategic plan, when it is planned in advance to purchase continuous work or function from a non-subordinate institution, warps the essence of strategic planning.

In cases where the operation of a budgetary institution is financed from budget appropriations assigned to other appropriation managers in the appropriation budget and who do not negotiate the amounts of such funding, there is a risk of unreasonable allocation and use of budgetary resources. Such funding practices need to be reviewed and, when there is a need for the acquisition of such functions (activities), institutions and bodies should coordinate this among themselves in their budget planning (Section 3.3).

Recommendations

To the Government of the Republic of Lithuania

1. Review programmes, funds and institutions funded in advance by statutory portion of fees and other revenues, assess the expediency and scope of their application, and limit to a minimum the number of such programmes, funds and institutions, ensuring that fixed funding is applied in the case when it is the only objectively reasonable method of financing (8th main audit result).
2. After having made the decisions on the scope of statutory pre-financing of programmes, funds and institutions with a share of taxes and other revenue sources, to establish the cases and objectives for this method of financing, procedure for determination and review of justified size of allocated funds, procedure for accounting for the activities financed this way and the use of funding (8th main audit result).
3. In order to ensure transparent and purposeful use of state budget funds, regulate the general principles of application of project (selection) financing method and general rules for applying such a method (*applicant selection, reporting, implementation control, project (selection) activity publication (both selection and results) and other general requirements*) (9th main audit result).
4. In order to ensure consistent application of the principles of strategic planning, provide measures to be taken, to ensure that the needs for funds of one appropriation manager for the purchase of permanent services (functions) from the other appropriation manager would be assessed during the preparation of the budget and necessary funds would be planned in the appropriations of the service (function) providing institution (10th main audit result).
5. Consider the need for liability insurance for budgetary institutions and/or employees as an additional (social) guarantee. In the event of a positive decision, initiate regulation of the possibility of such insurance in the relevant laws. In the event of a negative decision, take steps to prevent future purchases of such insurance services (5th main audit result).
6. Regarding the project activities of the Department of National Minorities under the Government of the Republic of Lithuania (9th main audit result):
 - 6.1. review the concept of funding minority culture and integration centres in an essential way: assess whether annual funding of projects for national minorities and integration centres (by securing funding for their activities) is the most appropriate way of financing the integration of national minorities into society. In the event of a positive decision, modify the funding arrangements for the Centre's operational projects in such a way as to ensure equal access rights for all centres to competitive project selection and not to allow the exclusive use of project funding by a circle of entities to maintain their activities or institution.
 - 6.2. assess the possibilities of separation of project activities of the Department of National Minorities, i.e. preparation and approval of financing provisions for project competitions, organization and administration of competitions, and, upon positive decision, change the legal regulation.

For the Ministry of Finance:

7. In order to improve the quality of the accounting processes of public sector entities, standardise the activity processes necessary for centralized management of accounting of the institutions (1st main audit result).
8. Review and update internal control legislation regarding the centralisation of the accounting function (1st main audit result).
9. Plan measures ensuring that all and final reporting period accountancy data of the State Tax Inspectorate Tax fund will be used for the compilation of the set of state budget execution reports (3rd main audit result).

For the Ministry of Education, Science and Sports

10. In order to ensure that the internal control system for grants to municipalities is conducive to ensuring the legality, cost-effectiveness and effectiveness of their use - evaluate the effectiveness of control measures developed by the Ministry and improve them in light of evaluation results (6th main audit result)

For the Ministry of Education, Science and Sports, Ministry of Social Security and Labour, Ministry of Culture

11. So far as reasonable, evaluate and separate the functions of legal regulation, tendering and administration of project (selection) funding arrangements to ensure transparency of tenders (9th main audit result).

For the Ministry of Education, Science and Sports, Ministry of Agriculture, Ministry of Culture, Department of National Minorities, Ministry of Social Security and Labour, Ministry of Environment, Ministry of Health Care, Public Institution Lithuanian National Radio and Television, municipal administrations

12. Until decisions are made regarding the legal regulation of project (selection) funding and the expediency of fixed funding, review and revise approved project (selection) funding arrangements, and select and consistently apply internal controls to ensure rational and lawful use of state budget funds (9th main audit result).

To the Ministry of Social Security and Labour

13. In order to properly implement NGO development policy (9th main audit result):
 - 13.1. collect and analyse information on the financing provided by state institutions to non-governmental organisations at the country level;
 - 13.2. establish evaluation criteria to assess the impact of community and non-governmental empowerment measures, which will allow for an objective measurement of the results achieved.

For the Ministry of the Interior

14. Evaluate the expediency of continuation of measures financed by the budget from another entity (Lithuanian Association of Municipalities), and in case it is determined that they need to be continued - ensure the legality of their financing (10th main audit result).

For the Ministry of Agriculture

15. Evaluate the scope of the functions delegated by the Ministry (calculation of funds allocated to municipalities to implement state agricultural functions and administration of the Register of fodder economy entities) to other entities and, upon deciding to transfer them to the State-owned company Agricultural Information and Rural Business Centre, amend the legislation accordingly, so that the possibility to receive state budget funds for the implementation of functions would be provided for in the relevant law (10th main audit result).

The summary contains recommendations that require systemic solutions or regulations that need to be improved. A list of all recommendations (not implemented by the end of the audit) to the entities, their implementing measures and deadlines are given in the "Recommendations implementation plan" section (see page 78).