Administration of Regional-policy Loan

Summary of audit results

The Chief Auditor audited the utilization of funds allocated for regional policy loan in 1995-1997 to find out whether the loan utilization has been legitimate and expedient, have measures been taken for the prevention of abuse and exploitative abuse of the funds and to establish the cases of exploitative loan abuse.

The reasons for performing the audit were the importance of the expedient utilization of the loan funds for the national regional policy, the total amount of allocations and the information concerning the danger of the funds allocated for regional policy loan being abused, received by State Audit Office.

In 1995-1997, 36.2 million kroons were allocated to the Ministry of Internal Affairs from the state budget for regional policy loans. In accordance to the data not audited the remaining amount was 12.6 million kroons at the end of 2001. All the interests accumulated over the period and 2/3 of the allocated funds had been written of as credit losses and administration costs.

Granting of the loan was organized by the regional policy loan commission, established in accordance to the precept issued by the Minister of Internal Affairs. Until May, 2002, the commission was chaired by the Deputy Secretary General of the Ministry of Internal Affairs Mr. Tiit Sepp; after that, the duties of the Chairman have been fulfilled by the Deputy Secretary General of the same ministry, Mr. Deiw Rahumägi.

In 1995, the Ministry of Internal Affairs concluded an administration contract with the Maapankade Investeeringute Aktsiaselts (Rural Bank Investments Ltd., presently AS Reginvest) for servicing of the loans, although in accordance to the procedures enforced by the Government the respective contracts should have concluded with the banks. During the period audited, the loans were exclusively serviced by AS Reginvest. In accordance to the administration contract concluded the purpose of the investment activities was to secure the profitability of the investments and continuing increment of the revenues.

In accordance to the administration contract it was possible to used the money allocated for regional policy loans not only for granting loans but also as investments in real estate and marketable instruments. The procedures enforced by the Government did not provide such opportunities. Regardless of the facts that the administration contract established specific limitations for the investment operations to be observed by the administrator, the loan administrator still breached the contract repeatedly.

The audit evidenced that the Ministry of Internal Affairs had not established unambiguous loan service requirements, including the principles for analyzing the applications. The loan commission also violated the loan granting procedures enforced by the Government by not demanding neither expert opinion on the loans disbursed from the entrepreneurship center nor the opinion of the county government concerning the loan projects. The information concerning the loan application and allocations was not made public; therefore, it was impossible to guarantee equal treatment of all the loan applicants.

The loan granting procedures enforced by the Government had also established that the loan applicant has to contribute 25% of the total value of the loan project. Neither the loan commission nor the loan administrator observed the self-financing arrangement, therefore, the loan projects were granted illegal financing in the amount of 6 million kroons. The loan administrator concluded all the loan contracts with the borrowers. During the audit it was discovered that the loan administrator had granted loans without demanding any securities or with insufficient securities, the value of which was not high enough to meet the claims of the creditors. Neither the loan commission nor the loan administrator analyzed the financial status of the borrowers and the value of their securities; the loans were also not classified in accordance to the level of related risks and the probability of reclaiming the loan amount. More than 6 million kroons in interests were forgone.

The audit revealed that the loan amount was not recorded in the book keeping records of the Ministry of Internal Affairs; it was also never shown in the annual reports.

The measures taken by the Ministry of Internal Affairs for controlling the expedient and legitimate utilization of the loan funds were not sufficient. The loan administrator has not submitted reports established with the loan administration contract; the Ministry also failed to provide any documents showing that the documents had been requested from the loan administrator before 21.08.2001.

The Ministry of Internal Affairs has not established the procedures for loan assessment, applying loan

provisions and writing off doubtful loans. The loan administrator has not paid enough attention neither to the economic activities of entrepreneurs who were granted loans nor the guarantors of loans and, ignoring the administration contract requiring the respective decision from the commission, has written off the total loan amount of 21 million kroons as expenditures.

The loan administrator didn't also observe the administration contract and the provisions arising from the rules of procedure of the loan commission when calculating the administration fees. Therefore, he gained more than one million kroons as illegitimate administration fee from June 2000 to December 2001. The loan commission's record of costs includes the payment of service fees to the consultant and fees for other services that, as established with the contract, should have been provided by the administrator.

The Ministry of Internal Affairs has not analyzed to what extent the objectives of the regional policy loan have been met: how did the loan influence the development of companies important for the region; was the business environment improved; how many new jobs were created, etc.

The Ministry of Internal Affairs has started the reorganization of the system for servicing the regional policy loans by devising specific actions and measures meeting that purpose.

Recommendations Made by State Audit Office:

State Audit Office made the following recommendations to the Minister of Internal Affairs:

- A draft law should be drawn up for the further utilization of the funds available from regional loan portfolio and submitted to the Government for discussion. State Audit Office considers it appropriate for the funds being repaid to the regional loan portfolio to be recorded as revenues in the state budget.
- All the loans granted by the loan administrator without the decision of the loan commission should be reviewed to decide whether the funds have to be reclaimed from the administrator (for example, a loan granted to Emmaste Dairy and Mear Cooperative, amounting to 600,000 kroons).
- Loans written off as expenditures (interests) should be reviewed to decide whether they can be reclaimed, including selling of the securities.
- The accurate value of the regional loan portfolio should be established. This will enable the accountants of the Ministry to record the claim, related to the funds of the regional loan portfolio, against the loan administrator and record this in the accounting system of the Ministry.
- The administration fee, amounting to 1.046 million kroons, received illegitimately by the loan administrator from June 2000 to December 2001 needs to be reclaimed; furthermore, the legitimacy of the payment of the administration fees over the remaining period needs to be ascertained.
- The issue of the accountability of officials at fault for the unsatisfactory supervision of the activities of the loan commission (including insufficient regulation and monitoring) should be clarified and settled.

State Audit Office has decided to send the audit materials and evidence to an investigative body for deciding whether criminal proceedings should be commenced against the officials at fault for the unsatisfactory administration of regional policy loans.

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