

# Financing of environmental projects through the Environmental Investment Centre Foundation

*Is the system for the distribution of the proceeds from environmental charges paid into the state budget transparent and does it ensure the purposeful and effective use of grants?*

Report of the National Audit Office to the Riigikogu; Tallinn, 12 June 2008

## Summary of audit results

Pursuant to the Environmental Charges Act the proceeds paid into the state budget from environmental charges are used for the purpose of maintaining and improving natural environment. The use of the proceeds for the specific purpose is organised by a state foundation called the Environmental Investment Centre which, by using the revenue from environmental charges, allocates grants to environmental projects aimed at maintaining the state of the environment, restoration of natural resources and remedying environmental damage.

The National Audit Office evaluated the transparency of the grant system financed from the proceeds from environmental charges paid into the state budget, and the functioning of the internal audit system of the Environmental Investment Centre upon purposeful financing of environmental projects.

The Environmental Investment Centre's grants contribute considerably to the realisation of private and public sector environmental projects, and are, in addition to the state budget, one of the main financial resources which help to achieve the goals set out in the state's environmental strategy.

From 2000 until 2007 the Environmental Investment Centre granted a total of 3.3 billion kroons to more than 10,000 environmental projects. In 2007 the Environmental Investment Centre allocated grants to 1,392 projects with a total cost of approximately 686 million kroons.

**It is the opinion of the National Audit Office that the system for the distribution of the proceeds from environmental charges is not transparent and the internal audit systems implemented do not ensure purposeful and effective use of grants.**

**The National Audit Office is of the opinion that the principal activities of the area of government of the Ministry of the Environment should not be financed through the Environmental Investment Centre's projects because the current organisation of the use of the proceeds from environmental charges diminishes the responsibility of the Minister of the Environment for the organisation of the field of the environment and enables the Minister to cover a significant part of the expenses incurred within the Ministry's area of government outside the Ministry's budget.**

Main observations:

- **The principles of distribution of the proceeds from environmental charges between the fields of the environment are not clear.** Each year the Minister of the Environment makes a proposal on how to distribute the proceeds from environmental charges between the fields of the environment. The audit showed that the Ministry does not have any clear criteria for deciding how to distribute the proceeds from environmental charges, and the connection of the proposal for the distribution of proceeds with the need to achieve the goals set out in the environmental development plans is not justified enough.
- **Principal activities carried out within the area of government of the Ministry of the Environment are being financed outside the state budget through the Environmental Investment Centre's grants.** In 2006 the Environmental Investment Centre allocated approximately 202 million kroons, i.e. 41% of the Environmental Investment Centre's total grants, for the projects of the Ministry of the Environment and its area of government. Through several projects of the Ministry's area of government activities which should actually have been included in the state budget were financed. Financing of the principal activities carried out within the Ministry's area of government through the Environmental Investment Centre reduces the transparency of the Ministry's budget because part of the Ministry's activities and expenses necessary to carry out those activities are left out of the budget.
- **The people evaluating projects evaluate the projects they themselves have prepared.** Financing of project applications submitted with the Environmental Investment Centre is decided by the supervisory board of the foundation based on the results of the evaluation of the applications organised by the Ministry of the Environment. Project applications are evaluated by the officials of the Ministry's departments of respective fields, who have prepared the project applications themselves. Therefore the project applications which have been prepared outside of the Ministry are in a less favourable situation than the projects prepared within the area of government of the Ministry of the Environment. It is the opinion of the National Audit Office that a situation where the officials of the Ministry of the Environment evaluate the projects submitted by the Ministry must be avoided.
- **Projects were often financed differently from the financing procedure established by the supervisory board of the Environmental Investment Centre.** Upon financing of environmental projects the time limits for financing and the payment schedules provided in the target financing contracts were not

always followed. In some cases the grant recipients received greater prepayments than permitted and they were compensated for expenses not directly linked to the realisation of their projects.

- **The supervision over grant recipients did not always confirm the purposeful and effective use of grants.** The audit showed that the documents needed to evaluate the conformity of projects with the requirements were often not completely filled in and included supposed conclusions regarding the conformity of the project.
- **The results of environmental projects are not evaluated.** The Environmental Investment Centre and the Ministry of the Environment have not, at the end of the projects financed from environmental charges, systematically evaluated the impact of the projects on the planned results.

#### **Responses of the Minister of Finance, the Minister of the Environment and the Manager of the Environmental Investment Centre:**

**The Minister of Finance** informed that a proposal is being prepared for the Ministry of the Environment regarding the transfer of the Environmental Investment Centre's rights of a founder in order to ensure a unique connection between the state's tasks and responsibilities, and more effective management of the foundation. The Ministry of Finance is of the opinion that resulting from the distribution of tasks provided in the Environmental Charges Act the entity actually exercising the rights of a founder is already the Ministry of the Environment because all the objectives of activities and financing related to the principal purpose of the Environmental Investment Centre depend on the position of the Ministry of the Environment.

**The Minister of the Environment** stated that the Ministry of the Environment has, in cooperation with the Environmental Investment Centre, significantly contributed to making the system for the distribution of the proceeds from environmental charges paid into the state budget more transparent, and to the legal regulation of the field. The Ministry's goal is to turn more attention to making the supervision of environmental projects (incl. technical supervision of the projects) more efficient in the coming years.

**The manager of the Environmental Investment Centre Foundation** informed that since 2005 a seminar on assessment of operating risks has been organised in the foundation each year. Based on the assessment of risks carried out in the course of such seminar, the management of the Environmental Investment Centre makes a decision on the organisational measures which will be implemented in order to manage the risks. The topics recommended by the National Audit Office regarding the projects handled in 2006 are all thoroughly analysed in the working materials pertaining to risk management. Risk management measures have been implemented in matters important to the Environmental Investment Centre. In 2006 and 2007 the Environmental Investment Centre has reorganised the operating procedures of its units by making the internal audit measures more efficient and by sending, if and when necessary, the employees of the Project Audit Unit in a flexible manner to perform concrete supervisory tasks.

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