

AUDIT AUTHORITY

ANNUAL CONTROL REPORT



IEGULDĪJUMS TAVĀ NĀKOTNĒ

ESF, ERDF, CF

01.07.2010. – 30.06.2011.

Rīga

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All the Annexes of the Annual Control Report are an integral part of this report.

ABBREVIATIONS

1 OP	Operational Programme “Human Resources and Employment”
2 OP	Operational Programme “Entrepreneurship and Innovations”
3OP	Operational Programme “Infrastructure and Services”
AA	Audit Authority
ACR	Annual Control Report
CA	Certifying Authority
CF	Cohesion Fund
CFCA	Central Finance and Contracting Agency
CHE	Centre for Health Economics
DG EMPL	Directorate General for Employment, Social Affairs and Inclusion
DG REGIO	Directorate General for Regional Policy
EC	European Commission
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
ISA	International Standards on Auditing
LGA	Latvian Guarantee Agency
LIDA	Latvian Investment and Development Agency
LMLB	Latvian Mortgage and Land Bank
LVL	Latvian lats
MA	Managing Authority
MCS	Management and control system
MEPRD	Ministry of Environmental Protection and Regional Development
MIS	Management Information System
MoC	Ministry of Culture
MoEcon	Ministry of Economics
MoESc	Ministry of Education and Science
MoF	Ministry of Finance
MoH	Ministry of Health
MoRDLG	Ministry of Regional Development and Local Government
MoT	Ministry of Transport
MoW	Ministry of Welfare
MUS	Monetary Unit Sample
OP	Operational Programme
PA	Paying Authority
PMB	Procurement Monitoring Bureau
RF	Reliability factor
SC	State Chancellery
SEA	State Employment Agency
SEDA	State Education Development Agency
SIF	Society Integration Foundation
SRDA	State Regional Development Agency

SUMMARY

1. Annual Control Report is prepared by Audit Authority according to Regulation (EC) No 1083/2006 Article 62. (1) (d), (EC) 1828/2006 (Annex VI and VII) and Guidance Note on Annual Control Report and Opinions.

2. In areas where Community budget is managed through shared management arrangements, the ACR and opinions are critical elements that the EC uses in order to assess how the member States have fulfilled their obligations and responsibilities for using Community budget appropriations.

3. The functions of the Audit Authority under the Operational Programmes: Infrastructure and Services (No 2007LV161PO002), Entrepreneurship and Innovation (No 2007LV161PD001) and Human Resources and Employment (No 2007LV051PO001) (hereafter – OPs) are fulfilled by the Ministry of Finance EU funds' audit Department (*Section 1.1*).

4. Random sample for the audits of operations was selected from the expenditures declared to EC within the period from 1 January to 31 December 2010 (*Section 1.2*).

5. The ACR covers in total all three Operational Programmes. There is a single Certifying Authority/Payment Authority and single Audit Authority. Functions of the Managing Authority are delegated to 15 Intermediate bodies (*Section 1.3*).

6. The Annual Control Report and audit opinion is prepared based on the results of management and control system audits and audits of operations. More detailed steps of preparation of ACR are described in *Section 1.4*.

7. Within the audit period the most significant changes in the management and control system are related to changes in the structure and methodology of the Audit Authority. The changes in the Managing Authority are related with reallocation of delegated functions. There were no any significant changes within the Certifying Authority (*Section 2*).

8. The Single Audit Strategy (dated 30 June 2010) have been updated and communicated to the EC as on 8 July 2011 including implementation of recommendations of the DG REGIO (*Section 3*).

9. As the result of the management and control system audits performed by the Audit Authority, the Managing Authority was assessed according to criteria 2 and the Certifying Authority -2. Meaning that the management and control system of the Managing Authority and the Certifying Authority are determined as working, but some improvements are needed. Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the key requirements/authorities/system. Recommendations have been formulated for implementation by the Audit Authority. Most of recommendations were implemented before issuing of audit opinion. Detailed information of the work done regarding management and control system audits are set out in *Section 4*.

10. Error rate identified by the Audit Authority in accordance with the results of the audits of operations is 1.76% that is below the materiality level, thus the expenditures declared to the EC are within the materiality level and are legal and regular. Results of audits of operations and overall opinion are detailed in *Section 5*.

11. The Audit Authority did not rely on the work of other auditors in preparation the ACR. (*Section 6*)

12. In total the recommendations have been implemented in accordance to the management and control system audit plan of implementation of recommendations. There

are 5 recommendations that are partially implemented and do not have an impact on the evaluation of ACR. (*Section 7*).

13. In audit reference period the Audit Authority performed two complementary audits of operations due to representativeness of sample of regular audits of operations and due to follow-up of implementation of ESF Financial engineering instrument. Audit approach and results of complementary audits are detailed in *Section 8.1*.

14. In order to implement one of the European Commission's recommendations formulated in the EC letter of 24 April 2011 on the EC fact-finding mission which took place in Latvia on 18-19 January 2010, the Audit Authority performed 2 special audits in June and July 2011 regarding ERAF Financial engineering instrument implementation. Audit approach and results of special audits are detailed in *Section 8.2*.

15. The Audit Opinion on effective functioning of the management and control system and the legality and regularity of the underlying transactions of expenditures declared to the EC for the reference period from 1 July 2010 to 30 June 2011 is based on the results of the management and control system audits and audits of operations. The management and control system has been assessed in category 2 and the error rate of the audits of operations is below the materiality level, thus the Audit Authority conclude to have an unqualified Opinion as it is set out in *Table 18 of Section 8.3*.

16. The work of the Audit Authority have been assessed by several audit bodies – the outsourced auditor company “Ernst&Young” SIA, DG EMPL, DG REGIO and the European Court of Auditors (*Section 8.4*).

17. During the reference period there was an interim payment suspension of the Operational Programmes “Entrepreneurship and Innovation” and “Infrastructure and Services”. As the result of the DG REGIO audit mission in June 2011 it was concluded by the EC that the measures taken by the national authorities for the strengthening of the independence of the Audit Authority and the improvement of the quality of the audit work performed to be satisfactory (DG REGIO 4 August 2011 letter No D(2011) 898718) and the interim payments have been renewed under suspended OPs except axis 2 measures of the Operational Programme “Entrepreneurship and Innovation”.

1. INTRODUCTION

1.1. Indication of the responsible Audit Authority and other bodies that have been involved in preparing the report

In accordance with the Law On Management of European Union Structural Funds and the Cohesion Fund for 2007–2013 and the Cabinet Regulation No 1153 “Procedures for Ensuring the Functions of the Audit Authority in the Management of European Union Structural Funds and the Cohesion Fund” the Ministry of Finance fulfils the functions of the Audit Authority.

In compliance with the Regulation of the Ministry of Finance¹ the European Union Funds Audit Department performs functions of the Audit Authority for the Operational Programmes: “Human Resources and Employment” No 2007LV051PO001 (1 OP), “Entrepreneurship and Innovation” No.2007LV161PD001 (2 OP) and “Infrastructure and Services” No.2007LV161PO002 (3 OP).

According to Regulation of Ministry of Finance the Audit Authority is directly subordinated to the State Secretary of the Ministry of Finance. In addition, the power to report directly to the Cabinet of Ministers via Minister of Finance is set by the Law On Management of European Union Structural Funds and the Cohesion Fund for 2007–2013 that is in force since 13 July 2011.

Since approval of Cabinet of Ministers Regulation No 1153 of 21 December 2010 there is single Audit Authority in Latvia. Prior to the approval of the Cabinet Regulation the function of the Audit Authority were delegated to internal audit units of the Intermediate bodies. However, according to the Single Audit Strategy the functions of the Audit Authority were centralized already since 30 June 2010, therefore this ACR is based solely on the audits performed by the Audit Authority and there were no reliance to the work of internal audit units of the Intermediate bodies. Audit reports of the internal audit units were used only as source of information for risk analysis and for getting the operational understanding of the institution at the management and control system audit planning stage.

1.2. Indication of the 12 month reference period from which the random sample was drawn

The random sample was drawn for the expenditures declared to the EC for the period from 1 January 2010 to 31 December 2010 and the actual audit work of audits of operations was carried out between 1 July 2010 and 30 June 2011.

1.3. Identification of the operational programmes covered by the report and of its Managing and Certifying authorities. Where the report covers more than one programme or Fund, the information shall be broken down by programme and by Fund

The Annual Control Report refers to the single management and control system that has been developed for the implementation of all three OPs and their relevant funds:

¹ Regulation of the Ministry of Finance No 12-16/7 dated 1 June 2011.

Table 1. Operational Programmes and respective funds

Operational Programme		EU Fund
1 OP	<i>Human Resources and Employment</i>	ESF
2 OP	<i>Entrepreneurship and Innovations</i>	ERDF
3OP	<i>Infrastructure and Services</i>	CF and ERDF

There is a single Managing Authority in Latvia that has delegated its tasks and functions to the 9 Responsible institutions (8 line Ministries and the State Chancellery) and 7 Co-operation institutions (including the Centre of Health Economics which was liquidated in 1 November 2011) corresponding to the three levels EU fund implementation:

- Managing Authority in general is responsible for communication with the EC, evaluation of the implementation of OPs and providing methodological support to Responsible institutions, Co-operation institutions and the beneficiaries;
- Responsible institutions' main tasks would include to setting up and determining the national legislation for implementation of the activities/subactivities in accordance to the sectorial competences, preparation of reports and financial planning to the Managing Authority on the implementation of the activity/subactivity and project application evaluation of restricted project application calls;
- At the level of Co-operation institutions – the project implementation monitoring and administrative checks (on-the-spot visits, progress report review, payment claim checks), reporting on irregularities, project selection and contracting with beneficiaries.

The State Treasury is performing the Certifying Authority's and Paying Authority's functions for all three OPs including certifying that the statement of expenditure are accurate and reliable, drawing up certified statements of expenditure and applications for payment and ensuring that adequate information from the Managing Authority on the procedures and verifications carried out in relation to expenditure has been received.

The duties and rights of the institutions involved in the management and control system of EU funds are defined in the Law On Management of European Union Structural Funds and the Cohesion Fund.

The information of the institutions involved in the administration of the OPs and EU funds are broken down in Table 2 below:

Table 2. Institutions involved in the management of EU funds

Operational Program	Function of	Institution
1 OP	Managing Authority	- Ministry of Finance
2 OP 3 OP	Paying Authority and Certifying Authority	- State Treasury
1 OP	Responsible institutions	<ul style="list-style-type: none"> - Ministry of Finance - Ministry of Economics - Ministry of Education and Science - Ministry of Welfare - Ministry of Environmental Protection and Regional Development² - Ministry of Health - State Chancellery
	Co-operation institutions	<ul style="list-style-type: none"> - State Employment Agency - Central Finance and Contracting Agency - State Education Development Agency - Centre for Health Economics³ - Latvian Investment and Development Agency - State Regional Development Agency - Society Integration Foundation
2 OP	Responsible institutions	<ul style="list-style-type: none"> - Ministry of Finance - Ministry of Economics - Ministry of Education and Science
	Co-operation institutions	<ul style="list-style-type: none"> - Central Finance and Contracting Agency - Latvian Investment and Development Agency - State Education Development Agency
3 OP	Responsible institutions	<ul style="list-style-type: none"> - Ministry of Finance - Ministry of Economics - Ministry of Education and Science - Ministry of Transport - Ministry of Welfare - Ministry of Environmental Protection and Regional Development - Ministry of Health - Ministry of Culture
	Co-operation institutions	<ul style="list-style-type: none"> - Central Finance and Contracting Agency - State Education Development Agency - Centre for Health Economics - Latvian Investment and Development

²Ministry of Environmental Protection and Regional Development established in the 1 January 2011 after joining the Ministry of Regional Development and Local Government and Ministry of Environment.

³From the 1 November 2011 functions of the Co-operation institution are delegated to the Central Finance and Contracting Agency due to the liquidation of the Centre of Health Economics.

		Agency - State Regional Development Agency
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1.4. Description of the steps taken to prepare the report

The Audit Authority prepares ACR in accordance with EC Regulation No 1083/2006 Article 62 point (1)(d), Commission Regulation (EC) No 1828/2006 Article 18 point (2) and the Cabinet of Ministers Regulation No 1153 “Procedures for Ensuring the Functions of the Audit Authority in the Management of European Union Structural Funds and the Cohesion Fund”. The Head of Audit Authority approves the ACR as authorized by the Ministry of Finance Order No 288 “About a circulation of documentation” dated 1 July 2011.

The Audit Authority does not rely on the work of other auditors as its functions are centralized in the Ministry of Finance⁴.

1.4.1. Information used for preparation of the ACR

The following information was used for preparing the ACR:

- 1) the results of the management and control system audits carried out by the Audit Authority over the reference period from 1 July 2010 until 15 December 2011;
- 2) the results of the audits of operations and complimentary sample for the expenditures declared to the EC within the period from 1 January 2010 to 31 December 2010;
- 3) Information from follow up procedures, results of analysis of errors discovered;
- 4) Information from reports of other audit bodies.

1.4.2. Key requirements and assessment criteria

In accordance with the updated management and control system audit risk assessment procedure as set in the updated Single Audit Strategy of 8 July 2011, the Audit Authority performs risk assessment in three levels:

1. Risk assessment per OP;
2. Risk assessment per institution;
3. Risk assessment on the horizontal systems.

The management and control system audits are planned in accordance with the risk assessment by listing the institutions in descending order (from highest risk to the lowest). Audit Authority begins with the system audits in the institutions with the highest level of risk in order to have enough time for implementation of corrective measures and follow up audits.

The results of the management and control system audits and audits of operations are the base for the annual Audit Opinion that is issued by the Audit Authority.

Within the audit reference period from 1 July 2010 to 30 November 2011 the management and control system audits has been performed in every institution that is involved in management of EU funds (19 in total) assessing all the key requirements that have been defined by the EC assessment criteria.

At the planning stage of the management and control system audits the internal control environment of the audited institution is assessed and the main risk factors for

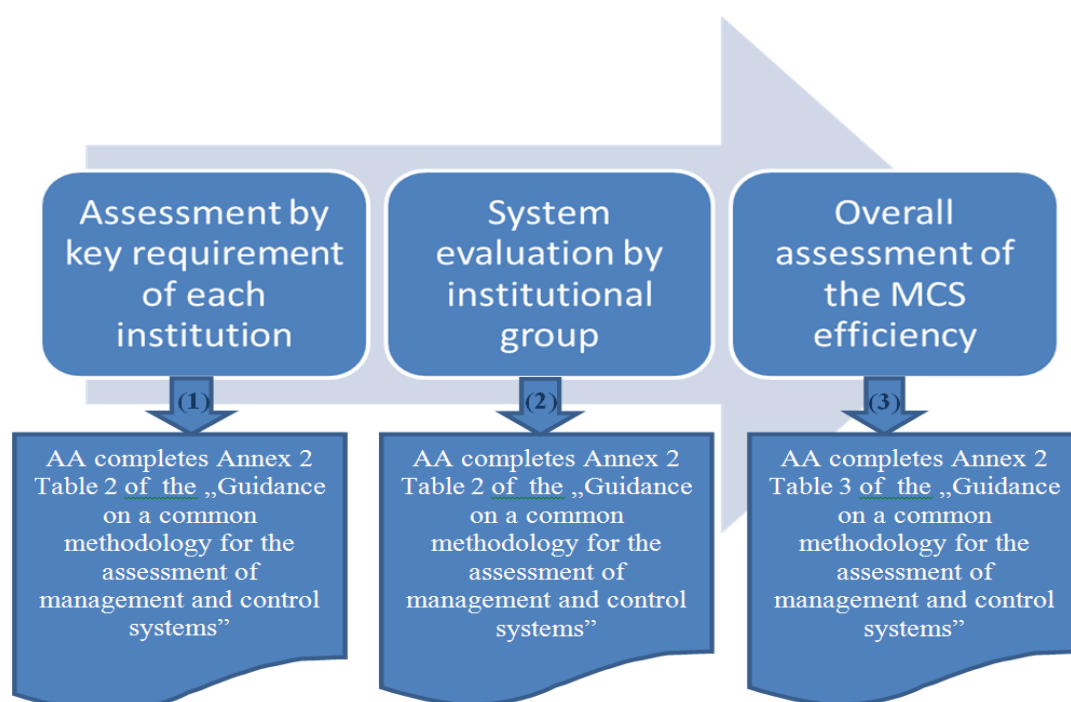
⁴ Officially since 21 December 2010 when the Cabinet Regulation No1153 became into force.

each key requirement are determined. In addition, all existing internal controls are identified for the audited institution, whether the controls are in compliance with the EU and national rules and regulations and the controls are sufficient to reduce the risks. The actual controls are tested and results assessed within the course of the audit.

1.4.3. Steps taken to reach overall conclusion and Audit Opinion

The preparation of the ACR is set out in the Audit Authority's procedure No 26 "The procedure on the preparation of the Annual Control Report of the European Union funds in the 2007 – 2013 planning period" that has been prepared taking into account the main elements of the management and control systems key requirements and assessment criteria in accordance with EC Regulation No1083/2006, EC Regulation No1828/2006 and EC "Guidance note on annual control reports and opinions".

Entire process of the ACR to reach the overall assessment of the management and control system can be set in 3 stages:



Stage 1. The assessment of the key requirements and assessment criteria are determined in the management and control system audits that are performed by the Audit Authority in each institution - Managing Authority, Certifying Authority/Paying Authority, 9 Responsible authorities and 7 Co-operation institutions. The audit results are reported in the audit report and summarized in the cumulative management and control assessment table. Detailed assessment of each key requirement and assessment criteria per institution audited are provided in *Annex 1* of ACR.

Each assessment criteria and key requirement is assessed in 4 categories as defined in the EC "Guidance on a common methodology for the assessment of management and control systems in the Member States (2007-2013 programming period)", see table 3:

Table 3. Category of the assessment criteria and key requirements

<u>CATEGORY</u>	<u>DESCRIPTION</u>
Category 1.	Works well; only minor improvements needed. There are no deficiencies or only minor deficiencies found. These deficiencies do not have any significant impact on the functioning of the key requirements / authorities / system.

Category 2.	Works, but some improvements are needed. Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the key requirements / authorities / system.
Category 3.	Works partially; substantial improvements are needed. Deficiencies were found that have led or may lead to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant. Recommendations and/or an action plan have been put in place. The Member State / The European Commission may decide to take corrective action (e.g. interruption or suspension of payments) in order to mitigate the risk of improper use of EU funds. to mitigate the risk of improper use of EU funds.
Category 4.	Essentially does not work. Numerous deficiencies were found which have lead or may lead to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant – it functions poorly or does not function at all. The deficiencies are systemic and wide-ranging. As a consequence, no assurance can be obtained from the assessment of the key requirements / authorities / system. A formal action plan should be prepared and followed up. The Member State / European Commission take corrective action (e.g. suspension of payments) in order to mitigate the risk of improper use of EU funds.

The assessment of each key requirement can not be classified more favourably than the worst of the assessment criteria.

Stage 2. The Audit Authority reaches a conclusion by the institution group and institution audited, based upon the results of the categorisation of each key requirement under Stage 1, subject to the following principles:

- 1) Some key requirements essential with regard to the regularity of expenditure and the proper functioning of the relevant authority:
 - Managing Authority: key requirement 4 (management verifications).
 - Certifying Authority: key requirement 3 (soundly based certification).
- 2) A classification in category 1 (Works well, only minor improvements needed) or 2 (works, but some improvements are needed) of the two essential key requirements mentioned above would have a positive influence on the overall conclusion, while deficiencies in other key requirements may downgrade the assessment for the relevant institution.
- 3) If the essential key requirements at point 1 above (or the relevant key requirement for each authority) are classified in categories 3 (Works partially, substantial improvements are needed) or 4 (Essentially does not work), the relevant authority cannot be assessed overall in a higher category. In other words, a higher classification of the other less essential key requirements for the authority in question cannot compensate for this deficiency.

The overall assessment of each institution group cannot be higher than the lowest assessment of relevant key requirement. For example, if one of institution is assessed according to category 3, overall assessment of Managing Authority cannot be higher (category 2 or 1).The conclusion of assessment of each institution/authority is summarized in *Annex 2*.

Stage 3.The Audit Authority concludes on the overall assessment of the management and control system by identifying any mitigating factors/compensating controls that may exist in one authority which effectively reduce the risk in the overall management and control system, in addition the residual risk to regularity is determined as concluded in *Annex 3.a*.

The overall conclusion by the management and control system provides a basis for determining assurance levels for formulating audit opinions and subsequent action, taking into account the results of audits of operations as provided in detail in *Section 5* of the ACR.

Audits of operations:

In accordance to the assurance level obtained from system audits, the confidence level is determined for the audits of operations. Before the sample is drawn, the sampling method and parameters of sampling are determined. There is one sample drawn every half a year including all three OPs. The detailed testing at the level of Intermediate Bodies and final beneficiaries is performed in order to assess whether the expenditures declared to the EC are legal and regular. As a result of audit of operations any irregular expenditure found, the Audit Authority evaluates the errors, reports to the auditee and calculates the error rate. More details on sampling methodology applied and the results see in *Section 5*.

The overall opinion is based on the results of the management and control system audits and results of audits of operations, more details are set out in *Table 18 of Section 8.3*.

2. CHANGES IN MANAGEMENT AND CONTROL SYSTEM

2.1. Indication of any significant changes in the management and control systems notified to the audit authority as compared with the Management and control description and of the dates from which the changes apply.

In the period from 1 July 2010 to 30 June 2011 the Managing Authority have made two updates to the Management and control system description as at: 30 June 2010 and 31 December 2010. The changes of the Management and control system as compared to the Management and control system description have been assessed by the Audit Authority for the period from 1 June 2008 to 30 June 2011. In addition, any post events that have occurred after the 30 June 2011 also have been taken into account by the Audit Authority establishing its conclusions and providing its opinion.

2.1.1. Changes in the period from 1 July 2010 to 31 December 2010

The most significant changes in the management and control system as compared with the Management and control description (updated by the Managing Authority as on 30 June 2010) for the period mentioned above have been reported in the ACR 2010, where the most significant changes were done in regards to the establishment of the Centre of Health Economics as on 1 October 2010 and centralization of the Audit Authority's functions within the Ministry of Finance.

2.1.2. Changes in the period from 1 January 2011 to the 30 June 2011, including the events that have occurred after the 1 July 2011.

Furthermore, the most significant changes in the management and control system as compared to the Management and control description (updated by the Managing Authority as at 31 December 2010) have been made within the PMB, Ministry of Environmental Protection and Regional Development, Ministry of Economics and the Audit Authority.

Procurement Monitoring Bureau

In order to strengthen the capacity of PMB and to improve the ex-ante activities in the area of public procurement 8 additional staff units were allocated to the PMB since

April 2011. The additional staff units allowed meeting the target set by the Managing Authority to perform the ex-ante public procurement verifications of at least 5 %.

However, the decision was made by the Managing Authority to focus PMB resources on the provisions of methodology work and to monitor the public procurement system's legality, remaining the function to perform procurement ex-ante checks of all major projects and on the sample basis for procurements of construction works above 1 mlj. LVL, also for procurements that have been published in the EU Official Journal. The Cabinet Regulation No.419⁵ (will become into effect from 2 January 2012) has been amended by delegating to perform procurement ex-ante checks to the Intermediate bodies.

Meanwhile, the PMB has prepared the methodology for performance of the procurement ex-ante checks and the Intermediate bodies are preparing the internal procedures in accordance to the methodology provided and setting up the plans and resources in order to perform procurement ex-ante checks.

As the changes will take effect from 2 January 2012 this does not affect this ACR and the audit Opinion provided by the Audit Authority.

Ministry of Environmental Protection and Regional Development

According to the Decree of the Cabinet of Ministers No 676 „About ensuring liquidation of The Ministry of Regional Development and Local Government of the Republic of Latvia” dated 22 November 2010 the Ministry of Regional Development and Local Government was incorporated within the Ministry of the Environment and new institution had been established from the 1 January 2011 – The Ministry of the Environmental Protection and Regional Development.

In order to assess the functioning and the compliance to the EC and national rules and regulations of the management and control system within the Ministry of the Environmental Protection and Regional Development the Audit Authority performed the management and control system audit from 21 February to 31 May 2011 and concluded the overall assessment of 2, more details of the system audit results are provided in *Annex4*.

Ministry of Economics

There have been changes in the internal procedure in the Ministry of Economics regarding the implementation of additional monitoring of the implementation of the projects and the reporting on irregularities detected as from the 15 November 2011. Changes are determined by the Audit Authority as additional controls (function delegated to the Co-operation institution) of the Ministry of Economics and will be assessed in greater detail in the management and control system audit in 2012.

Centre of Health Economics

In accordance to the Cabinet of Ministers Decree No 436 „On the re-organization of the Health Payment Centre and Centre of Health Economics” the functions of the Co-operation institution are delegated to the Central Finance and Contracting Agency as from the 1 November 2011. In order to ensure the proper implementation of the functions that have been taken over from the liquidated Centre of Health Economics, the human resources have been re-allocated (regarding project administration) to the Central Finance and Contracting Agency and 2 month supervisory control has been set for all the

⁵Cabinet Regulation No 419 “Procedures, by which Institutions Involved in the Management of European Union Structural Funds and the Cohesion Fund Ensure the Preparation of Planning Documents and the Implementation of Such Funds”.

actions taken to ensure the compliance with the Central Finance and Contracting Agency's rules and regulations.

As the Central Finance and Contracting Agency is determined as one of the largest EU fund administrator institutions with appropriate experience, the changes has been taken into account by the Audit Authority and determined as not to effect the assessment provided in ACR and the annual Audit Opinion that is provided for the reference period from 1 July 2010 to 30 June 2011.

The changes in the management and control system which impact opinion of Audit Authority are in compliance with requirements of Commission Regulation (EC) No 1083/2006 Articles 58 and 62.

Audit Authority

A couple of significant changes are implemented in order to strengthen the independence and capacity of Audit Authority, as well as the quality of the work of Audit Authority. More details are set *in Section 3*.

3. CHANGES TO AUDIT STRATEGY

The initial Single Audit Strategy was prepared and submitted to the EC on 29 September 2008. The acceptance of the Single Audit Strategy from the EC was received by letter No D(2009)6651 on 7 April 2009.

The latest updated Single Audit Strategy was submitted to the EC on 8 July 2011. The most substantial changes that have been made to the updated Single Audit Strategy are set in points 3.1 – 3.7 below.

3.1. In order to ensure the functional independence of the Audit Authority couple of steps have been taken:

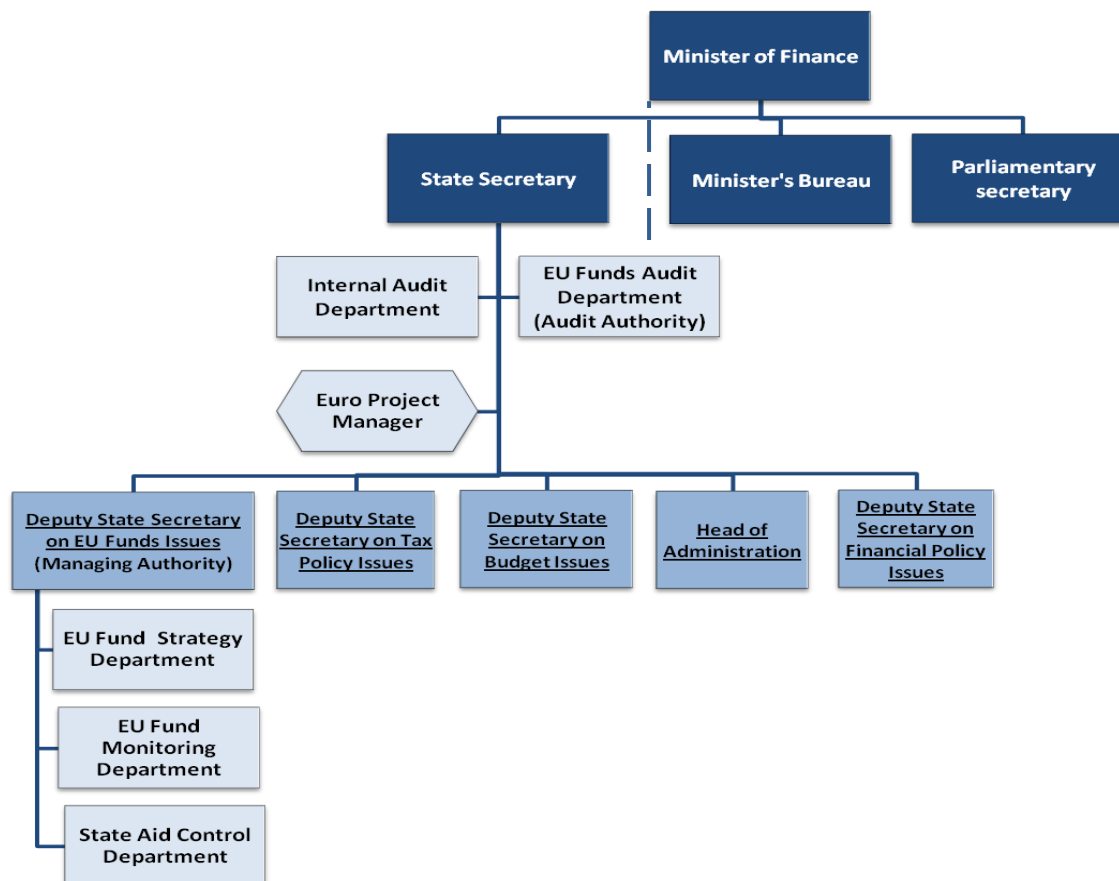
3.1.1. On 21 December 2011 the Cabinet Regulation No 1153 have become into force regulating the function of the Audit Authority.

3.1.2. The amendments to the Law on Management of European Union Structural Funds and the Cohesion Fund⁶ stating the rights of the Audit Authority to report directly to the Cabinet of Ministers via Minister of Finance.

3.1.3. There have been structural changes made within the Ministry of Finance by separating internal audit function from the functions of the Audit Authority. The organizational structure is set up in order to Head of the Audit Authority report to the Minister while being administratively subordinated to the State Secretary. The organizational structure of the Ministry of Finance is set out in Organizational chart below.

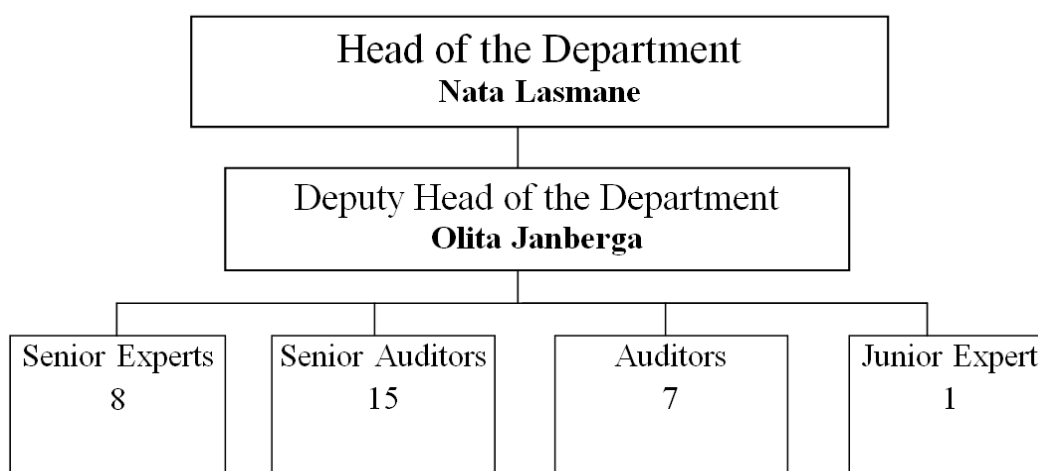
⁶ Law amendments became into force from 13 July 2011.

Structure of the Ministry of Finance



3.1.4. As a result of separation of the Audit Authority from the internal audit, the EU Funds Audit Department was established that is operating accordance with Department's Regulation No.12-16/8 of 8 June 2011. The EU Funds Audit Department has liquidated the structure of units and instead organized it's work in levels of the tasks and responsibilities of the auditors as per the organizational chart provided in the chart below:

Structure of the EU funds Audit Department



- Senior experts – responsible for preparing Audit Strategy, Annual Control Report, Annual Summary, Methodology support, planning and coordination

of audits and other areas as well as leading of different kind of specific projects and being in charge of audit engagements;

- Senior Auditors – in charges of audit engagements (planning and performing system audits and audits of operations, coordination of fieldwork, reporting, communication with auditees, follow up);
- Auditors – participation and performance of the system audits or audits operations in fieldwork;
- Junior Expert – responsible for keeping data bases and office work, technical support.

3.1.5. The capacity of the Audit Authority has been strengthened by allocating two additional staff units as from the April 2011;

3.1.6. Salary level in the Audit Authority has been increased and is at the same level as in the Managing Authority.

3.2. Management and control system audits are performed in accordance with International Standards on Auditing (ISA), Code of Ethics and internal procedure No ARD-19 “Procedure for the Audit Authority to conduct system audits of the European Union structural funds and Cohesion Fund in 2007–2013 programming period”.

3.3. Risk assessment of the management and control system audits is performed at two levels – per OP and per institutions that are involved in the management of the EU funds. In order to establish the risk priority, the Audit Authority determines the risk factors and assesses them in 3 point scoring system:

- 1 point is awarded if the effect of factor is low or there is no effect;
- 2 points are awarded if the operations are effected but can still operate;
- 3 points are awarded if the operations are seriously effected or the operations are suspended.

The overall risk is established by summing up all scores of factors and the priority of risk is set as follows:

Total risk assessment	Audit priority
11 – 21	Low
22 – 33	High

In addition the horizontal issues are determined and their risk is evaluated in the similar manner as per OP and institution. The overall risk is established by summing up all scores of factors and the priority of risk is set as follows:

Total risk assessment	Audit priority
9 – 18	Low
19 – 27	High

As a result of the risk assessment the institutions are ranked by auditing high risk institutions at the beginning of the audit period while predicting some time for the follow-up audits towards the end of the audit period.

- 3.4. Reliance to the work of other auditors. For the audit reference period the Audit Authority did not plan to rely on the work of internal auditors of the institutions that are involved in the management of the EU funds as it was before.
- 3.5. Audit Authority outsourced experts of construction works in order to improve the quality of on-the-spot evaluation of constructions works, technical specifications and procurement procedures.
- 3.6. Changes in the internal procedures regarding the methodology of the management and control system audits are detailed in *Section 4*. In addition the checklists of the audits of operations have been updated including detailed set up for public procurement, state aid and financial engineering instruments checks.
- 3.7. Reporting audit results. The management and control system audit report is prepared in accordance to the ISA 580, approved by the Head of the Audit Authority and submitted to the European Commission via SFC2007 system.

If the auditee does not agree to the irregular expenditure and it's estimated financial correction that has been identified by the Audit Authority, the Certifying Authority has to withhold the amount of the expenditure declaration.

- 3.8. The updated management and control system audit plan and the audit approach were presented to the EC in the Bilateral meeting on 16 April 2011.

4. SYSTEM AUDITS

4.1. Indication of the responsible audit authority and other bodies that have been involved in preparing the report

During the reference period all system audits solely have been performed by the Audit Authority that is located within the Ministry of Finance in EU Funds Audit Department (more details see in *Section 1.1*).

4.2. Summary list of the audits carried out (bodies audited)

The summary of the management and control system audits carried out during the reference period and not reported in the ACR 2010, indicating the OP, the audit body, the date of the audit carried out, audit scope, principal findings and conclusions, whether there were systemic deficiencies and the state of follow-up is set out in *Annex 4 of the ACR*.

As a result of the DG REGIO audit mission No 2010/LV/REGIO/J2/922 „*Review of the work of the Audit Authority 2007-2013*” in October 2010, the Audit Authority assessed all institutions that are involved in the management of the EU funds performing 19 audits in total (1 management and control system audits, 1 follow-up audit and 1 compliance assessment audit), in addition 2 audit engagements to perform agreed-upon procedures' regarding financial engineering instruments were carried out in accordance to the DG REGIO fact finding mission Ref. No 2007LV161PO001 „*Follow-up to fact finding mission to the Latvian Guarantee Agency (LGA) and the Latvian Mortgage and Land Bank (LMLB) of 18-19 January 2010*”.

In order to assess the management and control system in most efficient way and to cover all key requirements, some system audits were performed to cover the Responsible institution (the line Ministry) and its respective Co-operation institution in one single audit –Ministry of Health and the Centre of Health Economics; Ministry of Environmental Protection and Regional Development and the State Regional and Development Agency; Ministry of Education and Science and the State Education and Development Agency; Certification Authority and Payment Authority; Managing Authority and the Ministry of

Finance as Responsible institution; Ministry of Welfare and the State Employment Agency; State Chancellery and the Social Integration Foundation.

Management and control system audits covering 1 institution per 1 audit were performed in the following institutions: Ministry of Economics, Latvian Investment and Development Agency, Central Finance and Contracting Agency (performs functions of Co-operation institution for 4 Responsible Institutions); Procurement Monitoring Bureau Ministry of Transport and Ministry of Culture.

4.3. Description of the basis for selection of the audits in the context of the audit strategy

In accordance to the latest updated Single Audit Strategy that was submitted to the EC on 8 July 2011 via SFC2007, the approach of the risk assessment methodology has been changed from determining the risk of any specific system horizontally across all institutions to the risk assessment per OP and institution. More detailed information is set out in *Part 3 Changes to Audit Strategy point 3.3 of the ACR*.

As a result of the risk assessment all three OPs have been evaluated at a high risk priority, in total 13 institutions were assessed at high risk and 7 institutions – at low risk. The summary of the risk assessment per OP and institution for the period from 2011 to 2015 is provided in *Table 4*, also the detailed calculations and table of institutions is provided in the updated *Single Audit Strategy in Annex 6*.

Table 4. Summary of the Risk assessment per institution

OP	Responsible institution	Co-operation institution	Amount of EU funding	Total score of risk assessment	Priority
1OP	MoESc	SEDA	255 m	23	High
	MoW	SEA	162,7 m	22	High
	MoEcon	LIDA	68 m	17	Low
	MoH	CHE	28 m	22	High
	MoF	CFCA	18 m	16	Low
	SC	SIF	9 m	18	Low
	MEPRD	SRDA	43 m	21	Low
2OP	MoESc	SEDA	452,5 m	22	High
	MoEcon	LIDA	76,9 m	17	Low
	MoEcon	MoEcon ⁷⁷	106 m	22	High
	MoF	CFCA	23 m	14	Low
3OP	MoESc	SEDA	336 m	22	High
	MoW	CFCA	11,8 m	17	Low
	MoH	CHE	145,5 m	23	High
	MoT	MoT	138 m	31	High
	MoT	CFCA	22,5 m	22	High
	MEPRD	SRDA	323 m	24	High
	MEPRD	-	940 m	26	High
	MEPRD	CFCA	381 m	26	High
	MoESc	LIDA	324 m	19	Low
	MoC	CFCA	56 m	19	Low

⁷⁷ Financial engineering instruments

	MoF	CFCA	70 m	13	Low
Managing Authority				24	High
PMB				25	High
State Treasury				16	Low

In general, the Responsible bodies are line ministries that are competent in setting up the policy for certain area (i.e. Ministry of Health is responsible for the management of health policy in the state) their functions, amongst other, would include monitoring the implementation at the activity/sub-activity level, set up the project application assessment criteria and the planning documentation, manage the financial flow of the state budget and EU funds.

Functions of the Co-operation institutions are generally delegated to the state agencies, whose functions would include project application selection process, contracting with beneficiaries, EU fund monitoring at the level of projects, on-the-spot checks, and payment request approval, reporting on irregularities, evaluation of the procurement and publicity requirements.

None horizontal system audit have been performed during the audit reference period as all horizontal issues were determined during the system audits in each institution. Furthermore, all involved institutions were covered by system audits during the audit period.

4.4. Principal findings and conclusions drawn from the audit work for the management and control systems and their functioning, including the sufficiency of management checks, certification procedures and the audit trail, adequate separation of functions and compliance with Community requirements and policies.

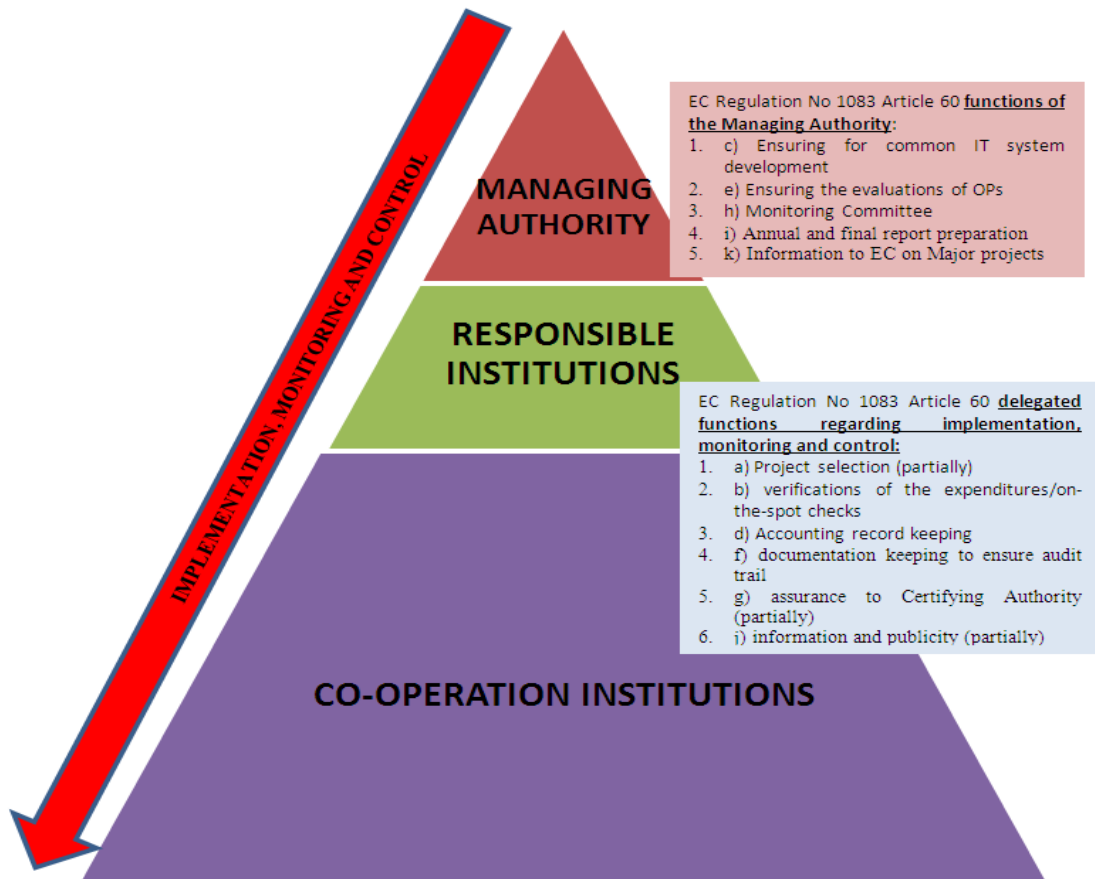
Summarising all information available at the disposal of the Audit Authority and by identifying any mitigating risk factors and compensating controls that may exist in one institution (*see Annex 3.a for more details*) which effectively reduces the risks in the overall management and control system, the Audit Authority concluded that the management and control system established in the Republic of Latvia in order to ensure the effective functioning of the EU funds is in the category 2 - works, but some improvements are needed, thus the average level of assurance has been obtained as a result of the management and control system audit.

The main findings and conclusions of the audits performed by the Audit Authority in the reference period that are taking into account in order to conclude the ACR and the audit Opinion are detailed in *Annex 4* indicating the OP audited, period when the audit have been performed, title, scope of the audit, main findings and conclusions, determination whether findings are of systemic nature and the implementation status of the recommendations.

4.1. Conclusion reached on the Managing Authority.

The Managing Authority of the EU funds for the 2007 -2013 planning period is based in the Ministry of Finance and it is responsible for administrating the following functions in accordance with EC Regulation No 1083/2006 Article 60, also see diagram in below.

Delegated functions of the Managing Authority



- ensuring establishment and implementation of computerised information system – Management Information System (MIS);
- evaluations of implementation of the OPs;
- organization of the monitoring committee;
- preparation and submitting of the annual and final reports on implementation to the EC;
- communication to EC regarding information of the major projects.

The rest of the Managing Authority functions (in regards of implementation, monitoring and control at the Priority/Activity/Project level) are delegated to the Intermediate bodies:

- project application selection process and setting up the assessment criteria for approval of the monitoring committee;
- verifications of the expenditure declared by the beneficiaries and on-the-spot checks;
- ensuring separate accounting system or an adequate accounting code for all transactions relating to the operation;
- setting up procedures to ensure that all documents regarding expenditure and audits required to ensure an adequate audit trail;
- assurance provided to the Certifying Authority (partially);
- compliance with the information and publicity requirements.

In order to conclude on the assessment of the Managing Authority, the Audit Authority audited all key requirements of all Intermediate bodies that are implementing the functions delegated by the Managing Authority providing that the overall assessment of the Managing Authority can not be higher than the lowest assessment of the institution of its delegated functions.

As a result of the management and control system audit in the Ministry of Finance as the Managing Authority and Responsible institution (audit report 24.10.2011.), the Audit Authority concluded that Managing Authority ensures the management of expenditures of EU fund and methodological coordination and supervision of all functions, however, the actual implementation of 6 functions (under 5 key requirements) it has delegated to the Intermediate Bodies. Considering that the Managing Authority has delegated certain functions and responsibilities to the Responsible institutions and Co-operation institutions and initialization and planning for additional supervisory actions of the delegated functions, the overall assessment for Managing Authority is not provided in the audit report.

However, as it is summarized in *Annex 2* after determining the overall assessment per key requirement for each institution involved in the management and control system, the Managing Authority is assessed in the category 2 – the management and control system within the Managing Authority is working but some improvements are needed in regards to:

- implementation of the control mechanism by performing on-the-spot checks in order to ensure the implementation of delegated functions;
- improve the control of the communication and publicity compliance;
- develop control mechanism regarding administrative checks, eligibility of expenditures included in the declaration, accounting records and audit trail of the Intermediate bodies.

4.2. Intermediate bodies

As a result of the management and control system audits it is concluded that the management and control system established within the Intermediate bodies is working effectively, however there are some improvements needed:

- double financing checks at the project application assessment stage;
- improvements in regards to the public procurement controls (documentation and evaluation of the projected price, criteria determination, detailed checks),
- information and publicity;
- maintain consistent project application evaluation;
- administrative checks (supporting documentation of expenditures and/or strengthen on-the-spot checks and procurement assessment);
- set up the mechanism for corrective and preventative actions;
- improve methodology of representative sample selection for payment claims checks.

4.3. Certifying Authority

The management and control system established in the State Treasury as the Certifying Authority and the Paying Authority is working effectively, but some improvements in order to obtain the evidence on a sample basis on the statements of expenditures and not to rely solely to the statements provided by the of the Responsible and Co-operation institutions.

4.4. Procurement Monitoring Bureau

The Managing Authority has delegated the public procurement control checks to the Intermediate bodies, including the ex-ante public procurement verifications to the Procurement Monitoring Bureau. The function of the Procurement Monitoring Bureau to evaluate procurement procedure (procurement plan, tender technical specification, type of intended procedure) is determined to be as an additional control. Thus, in accordance to the audit scope of the Audit Authority's management and control system audit in the Procurement Monitoring Bureau all key requirements were audited, however the overall assessment of the Bureau was not determined. The overall assessment of the Procurement

Monitoring Bureau can be provided in the unity with results of the procurement controls in Responsible and Co-operation institutions. Also considering the on-going changes in regards to the ex-ante public procurement verifications that will take effect from 2 January 2012, the Audit Authority will commence the horizontal public procurement horizontal system audit in order to obtain the sufficient grounds for the conclusion of the public procurement system in the EU fund administration.

As a result of the management and control system audit, the Audit Authority concluded that some improvements are needed in regards to:

- keep on working on the methodological support for the institutions and beneficiaries;
- preparation of procedure for sample selection of the ex-ante public procurement and keeping audit trail;
- determine whether the decision of the bureau is binding in collaboration with institutions Responsible and Co-operation institutions;
- emphasise restrictive criteria assessment;
- determine inventory of the user rights of the MIS access;

The above findings have been evaluated by the Audit Authority and do not have an affect of the overall management and control system operation.

4.5. Ministry of Transport

In the second quarter of 2011 the Audit Authority carried out management and control system audit in the Ministry of Transport. As the result of the audit the overall effectiveness of the management and control system of the Ministry of Transport was assessed as „works partially” due to the assessment of the following key requirements / assessment criteria:

1. Key requirement 4 / Criteria 10 – deficiencies were found in the procurement ex-post checks carried out by the Ministry of Transport, as the elaborated checklist was too general and did not ensure detection of all errors made by the final beneficiaries during procurement procedures.
2. Key requirement 7 / Criteria 22 and 23 – deficiencies were found in the applying of the necessary preventive and corrective action where irregularities were detected by the Audit Authority:
 - The action of the Ministry of Transport concerning irregularity found by the Audit Authority was belated.
 - The internal procedures of the Ministry of Transport concerning preventive and corrective actions were not well defined; the terms for making the decision in the case of irregularity were not stated.

In the 2nd quarter of 2011 the EC auditors during the audit mission No 2011/LV/REGIO/J2/958/1 re-performed the Audit Authority's work in the Ministry of Transport. In the result of the before mentioned EC audit mission the following additional risks were found concerning management and control system of the Ministry of Transport:

1. Selection of the projects within the Ministry of Transport – the evaluation of projects was made mainly based on the information provided by the applicants in the standard form applications, which can have high negative impact on the future implementation of the projects approved, as at the moment of the approval there was no real assessment of the readiness / maturity of the projects or of their feasibility.
2. Procedures in place at the level of the Ministry of Transport for the management verifications – administrative checks performed at the level of the Ministry of Transport on the payment requests can be still improved, as well as the frequency

and moment of the on-the-spot checks performed can still be optimized, in order to ensure that payments certified at the level of the EC are free of errors.

3. Unjustified use of shortened deadlines for 2 contracts of the Latvian State Roads – unjustified shortened deadlines have been used, based on the existence of a prior Information Notice.

Taking into account that the Ministry of Transport manages 27% of all allocated EU funds and taking into account the finding and risks from the Audit Authority's audit and EC's audit mission the opinion of the Audit Authority was that in the case of the Ministry of Transport the standard control procedures defined by the regulations are not sufficient and the Ministry of Transport should perform greater volume of control activities and checks. Based on this opinion the Audit Authority carried out the follow-up audit in the Ministry of Transport in 4th quarter of 2011 with the aim to follow-up the status of implementation of recommendations stated during the management and control system audit and assess the risks found during the EC's audit mission. In the result of the follow-up audit it was found that the following improvements of the management and control system of the Ministry of Transport were introduced up to 15 December 2011:

1. Procedures in place at the level of the Ministry of Transport for the management verifications were improved:
 - The checklist for administrative checks on the payment requests was improved by expanding the questions on procurement contracts addendums and it's compliance with the Public Procurement Law.
 - The checklist for administrative checks on the procurement procedures was improved by adding more specific and detailed questions in compliance with the Public Procurement Law.
 - The procedure for the on-the-spot checks was improved by stating that more frequent on-the-spot checks should be carried out in case when one beneficiary implements more than one project (mostly regards Latvian State Roads).
 - The procedure for the on-the-spot checks were expanded with the procedure for carrying out the Internal control system assessment for those projects for which evaluation was made mainly based on the information provided by the applicants in the standard form applications, as at the moment of the approval there was no real assessment of the readiness / maturity of the projects or of their feasibility. The Internal control system assessment will be carried out for such projects by the Ministry of Transport before or immediately after signing of project agreement in order to assess the financial standing of the beneficiary, the qualifications and experience of its staff and its administrative and operational structure as well as the readiness / maturity of the projects.
 - Taking into account the Ministry's of Transport explanation that all before mentioned criteria have been assessed during project evaluation, but this assessment was not documented, the procedures of the Ministry of Transport have been improved in order to comply with the EC "Guidance document on management verifications to be carried out by Member States on operations co-financed by the Structural Funds and the Cohesion Fund for the 2007 – 2013 programming period" and to keep documents, which proves that the Ministry of Transport ensures that beneficiaries have the capacity to fulfil a number of conditions before the approval decision is taken.
2. Procedures of the Ministry of Transport concerning preventive and corrective actions were improved stating the terms and detailed conditions of the decision making process in case of detected irregularities.

Moreover the Audit Authority during its follow-up audit found that:

- The management verifications (administrative and on-the-spot) carried out by the Ministry of Transport taking into account the improvements introduced

complies (including its timing and frequency) with the EC “Guidance document on management verifications to be carried out by Member States on operations co-financed by the Structural Funds and the Cohesion Fund for the 2007 – 2013 programming period”.

- The evaluation of projects mainly based on the information provided by the applicants in the standard form applications did not have negative impact on the future implementation of the projects approved and the adjustment in the projects agreements were not made more frequently in comparison with the other projects and these adjustments were not essential.
- The irregularities found in the time period after the Audit Authority’s last audit were treated in compliance with the provisions and terms of the EC and national legislation.

The unjustified use of shortened deadlines for the procurement contracts of the Latvian State Roads, based on the existence of a prior Information Notice was assessed by the Audit Authority during its follow-up audit. The conclusion was as follows:

1. Shortened deadlines based on the existence of a prior Information Notice were used systematically as regards procurements of Latvian State Roads.
2. The Audit Authority assessed the information which was available at the time the prior Information Notices were published and concluded that:
 - All the necessary information was published in the prior Information Notices or in the Latvian State Roads web page (http://www.lvceli.lv/lvc_iepirkumi/).
 - In the majority of procurement procedures sufficient number of offers were received (only in 2 cases out of 40 single offer was received), which proves that the deadlines were adequate for preparation of offer.

However, the Audit Authority found during its follow-up audit that the Latvian State Roads does not justify the price in the case of a single offer, the recommendation was stated the following actions were introduced:

- Latvian State Roads periodically carries out a research „Analysis of roads and bridges construction costs” in order to be able to plan necessary financing for the road construction and improvement projects. The before mentioned research are carried out by the outsourced company Deloitte Latvia SIA („Deloitte”).
- In order to identify the reasons for the high prices increase in the field of road construction the research work is carried out in collaboration with the Ministry of Economics and Central Statistics Bureau.

Improvement of roads quality monitoring system – in cooperation with Jaspers the technical specification is elaborated and experts are hired to support the improvement of supervision systems and quality assurance for road construction contracts.

4.5. Indication of whether any problems identified were considered to be of a systemic character, and of the measures taken, including a quantification of the irregular expenditure and any related financial corrections.

Audit Authority reformed the analysis of the errors and findings in order to identify their systemic or systematic nature. Deficiencies were found to be as procedural matter and not quantifiable, except for one finding in the State Education and Development Agency regarding application of irrelevant procurement procedure. As a result, all systemic and systematic deficiencies were verified in the follow-up audits and reported in system audits’ reports to the EC via SFC2007.

The most important systemic deficiencies identified by the Audit Authority during the system audits are:

- 1) Managing Authority should strengthen its position and do more on-the-spot work in order to supervise the delegated functions. Appliance of guidance issued by Managing Authority should be supervised in order to be sure that institutions have correctly implemented requirements of Communities or national legislation;
- 2) Managing Authority receives very wide range of information from intermediate bodies; however, reaction on this information is case-by-case nature. We recommended implementing the system on how the data should be analysed and how Managing Authority will react on the results of this analysis. In case Managing Authority is not satisfied with the work of any Intermediate body it should have enough power to require to strengthen the control system in particular intermediate body;
- 3) The double financing control checks;
- 4) There is no common approach or guidance how State aid rules have to be controlled;
- 5) Certifying authority performs very detailed control over payment supporting documentation, however, controls over procurement procedure and project selection is not sufficient;
- 6) The status of decision/opinion provided by the Procurement Monitoring Bureau should be clearly defined;
- 7) Price justification shoul be properly done and documented;
- 8) The opinion of outsourcing experts for project evaluation should be taken into account or documented why it has not been taken into account;
- 9) Amount of on-the-spot checks in regional offices of intermediate bodies should be increased and the first level control checks should be more effective.

The most important systematic deficiencies identified by the Audit Authority during the system audits are:

- 1) Deficiencies which could be corrected during the 1st level controls are not communicated to final beneficiary and timely corrected (procurement, publicity, traceability, storage of documents);
- 2) Insufficient documentation regarding price justification, a market research, checks of double financing and state aid rules;
- 3) Restrictive requirements in the procurement documentation;
- 4) Incorrect procurement procedure appliance (negotiating procedure), unferseen circumstances.

In total 1 recommendation was rejected by the MEPRDS and 3 recommendations were rejected by the SRDA (without financial impact):

- 1) The MEPRD and SRDA document the market research in order to justify the contract price, as well as to document the evaluation on the tender procedure documentation in order to determine whether there are not included too high or discriminative requirements for tender contestants. - The similar finding was concluded in the DG REGIO audit mission No 2011/LV/REGIQ/J2/958/1.

The management of the institutions provided explanation that the procurement contract price are determined at stage of the project application that makes up the total budgeted project amount. As there is no national rules and regulations stating what should be done in order to determine the projected procurement contract price, therefore institutions would need more guidance. Exact explanations of the institutions can be found in the Audit Authority audit report on the management and control system in the MEPRD and SRDA, dated and submitted to EC via SFC2007 on 31 May 2011.

The Audit Authority assessed whether the finding has a systemic/systematic nature at its compliance assessment audit (*see point No 2 in Annex4*) in the MEPRD and concluded that the procurement projected price documentation has a systematic nature and the issue regarding too high requirements for tender contestants is not a systemic/systematic nature and is set in accordance to the procurement technical specification to reach the objective of the procurement. In addition there will be conducted a horizontal procurement management and control system audit in order to determine the common implementation of the Public Procurement Law and the EC directives.

- 2) SRDA develop a mechanism for identification and evaluation of the State aid conditions at the project application evaluation stage. - The auditee explained that the mechanism set in the Agency is sufficient as the Cabinet of Ministers regulations sets out the assessment criteria on whether the project does not contain actions that are classified as State aid that is considered as sufficient mechanism. The recommendation in regards to the State aid assessment will be followed-up in the management and control system audit in the future audits.
- 3) SRDA to include the payment claim checks in regards to the compliance with the public procurement requirements including the projects that had no on-the-spot checks performed. As the internal procedures of the SRDA determines the procurement checks of on-the-spot checks and the regulations of the implementation of the activity sets out the responsibility of the final beneficiary to submit the documentation regarding the public procurement that has been assessed at the project application evaluation stage, it is determined as additional check and the present controls are satisfactory.

5. AUDITS OF OPERATIONS

5.1. Indication of the bodies that carried out the audits of operations, including the audit authority

Audits of operations regarding certified expenditure 2010 were carried out solely by Audit Authority (*See section 1.1.*).

5.2. Description of the basis for selection of the sample(s). Indication of the materiality level and, in the case of statistical sampling, the confidence level applied.

Audit Authority carried out audits of operations in accordance with Audit strategy updated at 30 June 2010.

Audits of operations are performed for expenditures declared to the European Commission during the period – from 1 January till 31 December 2010 within all three Operational Programmes:

- 1) Operational programme „Human Resources and Employment” (ESF) – 2007LV051PO001;
- 2) Operational programme „Entrepreneurship and Innovations” (ERDF) – 2007LV161PO001;
- 3) Operational programme „Infrastructure and Services” (CF and ERDF) – 2007LV161PO002.

Audits of operations are carried out within the reference period from 1 July 2010 till 30 June 2011. During reference period two regular audits were conducted (broken down by expenditures certified in 6 months period):

- 1) for the expenditures declared to European Commission from 1 January till 30 June 2010 (audit No AI/SAI-ESF/ERAF/KF-10/31);
- 2) for the expenditures declared to European Commission from 1 July till 31 December 2010 (audit No AI/SAI-ESF/ERAF/KF-11/19).

For each regular audit one population was formed and one selection done. Population included certified expenditures in first or second half of the year 2010 for all three operational programs.

Sampling unit is payment claim covering eligible expenditure approved by Certifying Authority and included in declarations submitted to the European Commission.

Sampling method was determined according to European Commission Guidance note on sampling methods for Audit authorities (COCOF 08/0021/01-EN) for each regular audit. General criteria taken in to account for determination of sampling method were number of sampling units in population. For expenditures certified in year 2010 both populations consist of more than 800 sampling units and sampling method used was statistical sampling – Monetary unit sampling.

For sampling 10 basic (no changes in standard values) selection parameters were used⁸, see *Table 5*.

Table 5. Parameters used for sampling

Parameters	Value
Assurance from the system (SP)	Average
Confidence level	70%
Book value of expenditure declared for selected half a year (BV)	2010 I half of the year – LVL 167 111 380,36 2010 II half of the year – LVL 144 185 474,06
Materiality level	2%
Tolerable misstatement (TM)	2%
Reliability factor (RF)	1,21
Anticipated misstatement (AM)	10%
Expansion factor (EF)	1,2
Interval	2010 I half of the year – LVL 2 430 710,99 2010 II half of the year – LVL 2 097 243,26
Sample size	2010 I half of the year – 65 units 2010 II half of the year – 62 units

From total 2774 payment claims regarding expenditure declared to European Commission in year 2010, 127 payment claims were selected (65 – first half of 2010, 62 – second half of 2010), broken down per audit see in Table 6.

Table 6. Expenditure declared during year 2010 and selected units

Population size (Expenditure declared during year 2010)		Selected sample			Exact verified expenditures		
units	LVL	units	LVL	%	units	LVL	%
Expenditure declared till 30.06.2010							

⁸ All parameters determined according to European Commission Guidance note on sampling methods for Audit authorities (COCOF 08/0021/01-EN)

1 172	167 111 380,36	65	61 856 798,95	37,02	65	62 062 282,42 ⁹	37,14
Expenditure declared till 31.12.2010							
1 602	144 185 474,06	62	71 427 448,13	49,54	62	55 974 206,46	38,82
Total:							
2 774	311 296 854,42	127	133 284 247,08	42,82	127	118 036 48,88	37,92

5.3. Description of the principal results of the audits of operations.

Results of audits of operations broken down by operational programs are included in Table 7.

Table 7: Results of audits of operations

	Certified expenditures (LVL)	Izlase (vienības)	Audited expenditure (LVL)	Irregular expenditure found within sample	Error within sample
Izdevumi, kas deklarēti līdz 30.06.2010.	167 111 380,36	65	62 062 282,42	35 939,78	0,06%
1 DP (ESF)	54 953 831,08	19	31 635 796,19	30 764,86	0,10%
2 DP (ERAF)	11 595 569,02	9	3 899 292,72	31,43	0,00%
3 DP (KF and ERAF)	100 561 980,26	37	26 527 193,51	5 143,49	0,02%
Expenditures declared till 31 December 2010	144 185 474,06	62	55 974 206,46	1 074 937,17	1,92%
1 DP (ESF)	70 333 731,30	31	32 044 201,41	24 526,01	0,08%
2 DP (ERAF)	27 536 802,09	15	16 313 181,88	1 050 411,16	6,44%
3 DP (KF and ERAF)	46 314 940,67	16	7 616 823,17	0,00	0,00%
KOPĀ:	311 296 854,42	127	118 036 488,88	1 110 876,95	0,94%

According to the second subparagraph of Article 17(4) of Commission Regulation (EC) No 1828/2006 projected error rate were calculated and compared with the set materiality level – 2%, in order to reach conclusions for the total population.

As for both populations MUS sampling was used according to the European Commission Guidance on treatment of errors disclosed in the Annual Control Reports (COCOF_11-0041-01-EN) and the Guidance note on sampling Methods for Audit Authorities (COCOF 08/0021/01-EN) conclusion for the total population were reached in several steps:

- 1) Projected misstatement in population was determined. Projected misstatement in population is total amount of calculated projected misstatements for each payment claim where misstatements were found. Projected misstatement for payment claims where misstatements were found are calculated multiplying misstatement rate (amount of misstatement divided with amount of expenditure where misstatement where detected) with MUS interval;
- 2) Basic precision is determined. Basic precision is multiplication of reliability factor (RF) with MUS interval;

⁹ One of selected payment claims within 2 OP were from Technical Assistance Project. Selected amount were regarding 2 OP, however hole payment claim was audited, and additional amounts regarding 1st and 3OP were added.

- 3) Incremental allowance for the sampling error is determined. Incremental allowance for the sampling error is total amount of calculated allowances for each payment claim where misstatements are found. Allowance for each payment claim where misstatements were found is calculated multiplying projected misstatement with weighted confidence factor;
- 4) Upper error limit of population is determined. Upper error limit is sum of projected misstatements in population, basic precision and incremental allowance for the sampling error.
- 5) Most likely error is determined, dividing book value of expenditure declared for selected half a year with upper error limit.
- 6) Most likely error is compared with materiality level.

Detailed calculation of most likely error for both audits is enclosed in *Annex 5 and 6*.

Projected error rate for:

- 2010 I half of the year – 1,76%;
- 2010 II half of the year – 1,76%.

Total projected error rate for the year 2010 expenditure is 1,76%, and does not exceed materiality level – 2%.

Conclusions reached after the qualitative analysis performed is described in Section 5.4. Regarding projected error rate calculation – all errors found regarding year 2010 expenditures were classified as systemic errors and were projected to the population, no anomaly/ individual errors were determined.

5.4. Conclusions drawn from the results of the audits of operations with regard to the effectiveness of management and control system

For the reporting period according to Article 16(2) of Commission Regulation (EC) No 1828/2006 results of regular audits of operations provide reasonable assurance that statements of expenditure submitted to the European Commission for all 3 operational programmes are correct and underlying transactions are legal and regular, except in separate cases when noncompliances were identified in fields highlighted in Table 8. Total projected error rate for expenditure declared to European Commission in year 2010 is 1,76%, and does not exceed materiality level.

Table 8. Errors found broken down by operational programs and fields

Field of error	Number of errors			Total
	1 OP	2 OP	3 OP	
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
Systemic errors				
Procurement	6	-	1	7
Publicity	4	1	9	14
Project selection	-	-	10	10
Eligibility of expenditures	1	-	-	1
Supervision of project implementation	-	21	-	21
Non-systemic errors				
Eligibility of expenditures	5	2	1	8
Supervision of project implementation	-	-	4	4
Noncompliance with contract	-	1	-	1

Not achieved the objective of the project	-	1	-	1
Design of supporting documents	4	-	4	8
Storage of supporting documents	2	-	-	2
Total	22	26	29	77

Overall qualitative analysis performed on the errors found and their significance and their causes as estimated by the Audit Authority is indicated in *Annex 7*.

Detailed qualitative analysis on the errors (systemic) and their significance and causes found during audits of operations has been performed and is described in the Section 5.6.

5.5. Information on the follow-up of irregularities, including revision of previously reported error rates.

Detailed description of recommendations regarding finding and errors detected in audits of operations regarding year 2010 and implementation status of those recommendations are summarized in *Annex 8*.

In total as a result of regular audits of operations Audit Authority issued 36 recommendations. Implementation status of issued recommendations in the time of issuing opinions and Annual control report:

- 19 – recommendations implemented;
- 1 – recommendation revoked;
- 4 – recommendations partly implemented;
- 11 – the deadline of implementation of recommendations not in force;
- 1 – recommendation not agreed. Recommendation was issued to Managing Authority in relation to necessary actions that should be taken to treat systemic errors that have been detected during the audits of operations. Although the recommendation was not agreed by Managing Authority has taken a number of activities to reduce / eliminate systemic deficiencies:
 - Changes in national legislation regarding procurement (*refer to Section 2.1.2.*);
 - Strengthening of capacity of PMB (*refer to Section 2.1.2.*),
 - Specification of responsibilities of institutions involved in procurement checks (*refer to section 4.4*).

One case of suspected fraud was identified during regular audits of operations for 2010 expenditure. Suspicious were detected regarding 2 OP activity 2.1.2.4.project No 2DP/2.1.2.4.0/09/APIA/LIAA/052 and Audit Authority immediately informed (with 25.05.2011 letter No 15-3-01/3499) responsible national authorities – State Police office. Suspicion arose because final beneficiary after submission of application without substantiation changed company who loaned money for financing of project (new lender was new Spanish company with unstable financial indicators and financed 100% of final beneficiaries part), representative of the final beneficiary was the same person who are partner in lender company, signed pre-contract between final beneficiary and lender company was not stamped and actual implementation was not started in one year after start of project implementation.

On 22 September 2011 Audit Authority received reply (letter No 20/2-3-24545) from State Police Central Criminal Police Department Economic Crimes Board with notification that they will not start criminal process because of lack of presence of intentional behavior in that case (Criminal process law Article 377 (1)).

Audit Authority on the basis of information received from experts decided that fraud case had not occurred. However, project financing has been recovered and Agreement on project implementation was terminated in 9 August 2011

Information about suspected fraud was also entered in European Commission OLAF IT system IMS with ID No R1681/LV/2011/LIAA/10013/1.

There were no changes in determined and reported error rates regarding Annual Control Report 2010.

5.6. Problems which are considered systemic in nature, and the measures were taken.

Audit Authority performed qualitative evaluation of problems identified and considered that several of them are with systemic nature in fields of:

- 1) Procurement – legislative requirements are not met or partially met. Non-compliances identified regarding – inadequate application of negotiation procedure, procurement contract signed violating the deadlines set in legislation, conflict of interests, and the contractor's compliance with the requirements of tendering documents. 7 non-compliances detected within 1 OP and 3 OP, 6 of them with financial impact;
- 2) Publicity – final beneficiaries didn't comply or partly comply with the minimum requirements of publicity and visual identity. 14 non-compliances detected within all 3 OP and 2 of them with financial impact;
- 3) Project selection process – traceability of project selection process is not provided adequately. 10 non-compliances without financial impact detected in one particular 3 OP measure 3.5.1 "Infrastructure of Environmental Protection". Responsible authority didn't documented appropriately selection process – evaluation regarding discount rates;
- 4) Eligibility of expenditures – 1 non-compliance without financial impact detected in 1 OP measure 3.4.1 "Social Inclusion", where within one sub-activity national legislative acts does not clearly determine period in what maximal amount of expenditures can be applied;
- 5) Supervision of project implementation – 21 non-compliances without financial impact detected in one 2 OP measure 2.3.2 „Business Infrastructure and Improvements to Equipment”, when during implementation of sub-activity "Business Incubators":
 - Sufficient control of compliance of final beneficiaries with requirements stated in national legislation is not ensured;
 - Sufficient record of *de minimis* support is not ensured.

Breakdown of systemic errors and their financial amount is presented in Table 9.

Table 9. Systemic problems

Field of error	1 OP		2 OP		3 OP		Total ineligible expenditure (LVL)	Total ineligible expenditure outside the sample (LVL)
	Number of errors	Ineligible expenditure (LVL)	Number of errors	Ineligible expenditure (LVL)	Number of errors	Ineligible expenditure (LVL)		
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>	<i>9</i>
Procurement	6	53 353,61	-	-	1	5 143,49	58 497,10	292 609,28
Publicity	4	7,26	1	31,43	9	-	38,69	117,47
Project selection process	-	-	-	-	10	-	-	-
Eligibility of expenditures	1	-	-	-	-	-	-	-
Supervision of project implementation	-	-	21	-	-	-	-	-
Total	11	53 360,87	22	31,43	20	5 143,49	58 535,79	292 726,75

As a result of detected deficiencies with systemic character that were found during the audits of operations, the Audit Authority has performed actions listed below:

- 1) Procurement: to eliminate deficiencies in procurement procedures found on the project level, recommendations were given on the project level and on the level of Intermediate bodies to improve the management and control system (*see Section 4.4*). Also the Audit Authority plans to perform horizontal management and control system audit in the next reference period. In addition horizontal changes in first level controls regarding procurement checks will be implemented and management control system improved in field of procurement (*please see, Section 2.1.2.*);
- 2) Information and publicity: As the deficiency was found in all three Operational programmes, the recommendations were given to eliminate particular deficiencies within the projects and recommendations to the Intermediate bodies were given to strengthen first level controls, paying additional attention to compliance with the information and publicity requirements within projects. In addition, the recommendation to the Managing Authority was formulated to take necessary actions in order to strengthen the supervision over elimination of stated deficiency. At the moment of preparation of the ACR, the Cabinet of Ministers Regulations on the Publicity requirements No.749 of 4 October 2011 “Procedures for compliance with publicity and visual identity requirements and publishing information on EU funded projects” are re-issued. Although the deficiency was classified as systemic, as a result of quantitative analysis of deficiencies, the financial impact estimated as not material.
- 3) Project selection process – adequate traceability of project selection process (evaluation of several selection criteria) is not provided. Taking into account that the deficiency was detected in one particular 3 OP measure 3.5.1., where the Ministry of Environmental Protection and Regional Development fulfills the functions of Responsible Institution, the recommendation was given for elimination of the deficiency which at the moment of preparation of the ACR is implemented. The Ministry of Environmental Protection and Regional Development systematically and in detailed manner documents project selection process. In addition, the project selection process in the Ministry of Environmental Protection and Regional Development was checked during the system audit, and results of the audit are

included in the management and control system audit report No.ESF-1A,1C-11/24 (please, see Annex 4).

- 4) Eligibility of expenditures – Taking into account that the deficiency was detected in only one sub-activity of 1 OP, the respective recommendation was given to the Ministry of Welfare. At the moment of preparation of the ACR, the recommendation is implemented. On 29 November 2011 amendments are made to national legislative act – Cabinet of Ministers Regulation No 258 of 8 April 2008 “Rules for the Operational Programme "Human Resources and Employment" sub-activity "Supported employment activities for unemployed population"”.
- 5) Supervision of project implementation – taking into account that the deficiency was detected in only one activity of 2nd Operational programme and in only one Cooperation Institution – LIDA, the recommendation has been formulated for implementation by LIDA. At the moment of preparation of the ACR, the recommendation implementation term has not expired, as well the Audit Authority plans to perform a management and control system audit in by Latvian Investment and Development Agency in the next reference period.

As it is stated above only two systemic errors with financial impact – public procurement and publicity were detected and, in addition to system improvements, Audit Authority evaluated also necessity for additional selection of items for audit in those fields. After evaluation Audit Authority concluded that problems in publicity are with minor financial impact and further evaluation is not necessary. In field of procurement Audit Authority evaluated overall situation in solving problems in procurement and concluded that improvements are already in process (please see, *Section 2.1.2.* where further changes in management and control system regarding procurement are highlighted) and additional selection is not necessary.

6. COORDINATION BETWEEN AUDIT BODIES AND SUPERVISORY WORK OF THE AUDIT AUTHORITY

6.1. Description of the procedure for co-ordination between different national audit bodies and the audit authority itself

For the Annual Control Report purposes and the Opinion of the Audit Authority 2011 as the functions of the Audit Authority have been centralized in the Ministry of Finance, the Audit Authority did not relay on the work of internal audit bodies or any other body.

6.2. Description of the procedure for supervision applied by the audit authority to other audit bodies

Not applicable.

7. FOLLOW UP OF PREVIOUS YEARS' AUDIT ACTIVITY

The Audit Authority has collected the information on the recommendations that are due as on 30 November 2011 and concluded that the institutions that are involved in the management of the EU funds do implemented the system audit recommendations in accordance with the action plan, however there are 5 recommendations that are in the process of implementation and 1 recommendation is outstanding:

1. As a result of the DG REGIO audit mission No 2009/LV/REGIO/J4/790/1
“ERDF, CF and ESF – Estimation of error rate in EU 27- programming period

2007-2013” 4 recommendations were provided for Audit Authority to follow-up in September 2010. Currently 1 recommendation has been implemented, 2 recommendations are at the implementation stage and 1 recommendation is not implemented:

- *The Ministry of Economics to inform the Audit Authority on the exit policy for each financial instrument and on the update of the Funding Agreement Annex E of the European Investment Fund and The Ministry of Economics to inform the Audit Authority on the amendments made to the Funding agreement between the Government of Latvia and European Investment Fund Appendix A Investment Strategy and Planning* - the implementation of the recommendations are in process as the Ministry of Economics in collaboration with the Latvian Guarantee Agency and European Investment Fund has begin to draft the takeover of the Funding Agreement.
 - In regards to the recommendation to European Investment Fund to enhance the transparency of the selection procedure by ensuring that the quality assessment criteria are weighted in calls and that they are applied by the members of the evaluation panel – as there were no calls made to select the financial intermediaries, the Audit Authority could not assess the implementation of the recommendation.
2. The Ministry of Economics is in the process to implement the recommendation regarding the project progress control checks as there is an internal procedure prepared but the checklists still should be updated to include all assessment criteria as per the procedure.
 3. Ministry of Environmental Protection and Regional Development has updated 3 out of 4 Department Regulations as the regulation on the Electronic Government Department that was at the reconciliation stage with the management of the Ministry.
 4. Ministry of Environmental Protection and Regional Development is in process of implementation of the recommendation in order to determine the functions, tasks and responsible staff of the project progress checks as the job description is at the agreement stage with the management of the ministry.
 5. The Audit Authority implemented recommendation of the European Commission’s fact finding mission in the Latvian Guarantee Agency and Latvian Mortgage and Land Bank as stated in the EC letter of 24 April.

More details of the implementation of the above mentioned recommendation are reported in the Audit Authority audit No 1DP/2DP/3DP-MCS-11/51 report. The recommendations that in the process of the implementation have been evaluated by the Audit Authority and determined as not to have a significant effect on the conclusions of the ACR.

Regarding implementation of recommendations of audits of operations – there were 13 open recommendations reported in previous ACR (see Annex 7). At the moment of preparation of current ACR, there are still 1 recommendation that is in the process of implementation and 2 recommendations that are not due until 31.12.2011.

8. OTHER INFORMATION

8.1. Complementary audits of operations

In audit reference period the Audit Authority performed two complementary audits of operations:

8.1.1. Complementary audit of operations due to representativeness of sample.

Audit No AI/SAI-ESF/ERAF/KF-11/44 from 1 August to 11 October 2011 was performed as selection results of regular audits of operations of 2010 expenditure, in accordance with Single Audit Strategy updated in 30 June 2010 and methodology of Audit Authority, were not representative. Representativeness of sample according to Single Audit Strategy and methodology has to be evaluated according to 3 criteria – whether sample is covering:

- at least 25% of expenditure declared to EC for each OP,
- at least 5% of payment claims within each OP;
- at least 10 payment claims from each cooperation institution's administrated projects that are included in the population.

After evaluation of selection results of both regular audits of operations it was concluded that 2 of 3 criteria were not met:

- at least 5% of payment claims within each Operational programme were not represented. Detailed evaluation is presented in *Tables 10 and 11*.

Table 10. Number of payment claims certified in year 2010

Year 2010	1 OP	2 nd OP	3 OP
I half	265	172	735
II half	731	198	673
Total:	996	370	1408

Table 11. Number of payment claims selected for regular audits of operations

Year 2010	1 OP	2 nd OP	3 OP
I half	19	9	37
II half	31	15	16
Total:	50	24	53
%	5	6	4

Conclusion – 9 additional payment claims have to be selected from expenditures of 3 OP.

- selected payment claims did not represent at least 10 payment claims from each cooperation institution's administrated projects that are included in the population. Detailed evaluation is presented in *Table 12*.

Table 12. Selected payment claims per institution

Institution administrating expenditures declared in 2010	Number of payment claims selected from expenditure of I half of 2010	Number of payment claims selected from expenditure of II half of 2010	Total of payment claims selected from expenditure of 2010
MoT	7	5	12
MEPRD	12	4	16
CFCA	4	5	9
LIDA	12	17	29
SEA	12	17	29

SIF	0	0	0
CHE	6	1	7
SEDA	5	11	16
SRDA	7	2	9
Total:	65	62	127

Conclusion – additional payment claims have to be selected from payment claims that are administrated by – CFCA (1 payment claim), SIF (10 payment claims), CHE (3 payment claims) and SRDA (1 payment claim).

Taking in to account necessity to fulfill all 3 criteria of representativeness, it was determined that complementary sample shall cover:

- 9 payment claims within 3 OP;
- 1 payment claim from CFCA;
- 10 payment claims from SIF;
- 3 payment claims from CHE;
- and 1 payment claim from SRDA.

Sample was taken from the expenditure certified and declared to the European Commission during the period from 1 January to 31 December 2010. The selection was done using random sampling method – determining of the random starting point and, if necessary, the applying interval.

Selection was done combining all necessary representativeness criteria – OP with criteria regarding institution. As a result total number of items (payment claims) selected was 19.

Results of complementary audit of operations identified errors in the same fields that were determined as systematic after evaluation of results of regular audits of operations – procurement and publicity, and some non-systemic errors regarding – compliance with requirements of contract, eligibility of expenditures and supervision of project implementation.

Breakdown of errors identified in complementary audit of operations and their financial impact is presented in *Table 13*.

Table 13. Results of complementary audit

Field of error	Systemic/ non- systemic (S/N)	1 OP		3 OP		Total ineligible expenditure (LVL)	Total ineligible expenditure outside the sample (LVL)
		Number of errors	Ineligible expenditure (LVL)	Number of errors	Ineligible expenditure (LVL)		
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>
Procurement	S	-		10	6 730,30	6 730,30	17 319,70
Publicity	S	5	48,43	1	6,60	55,03	870,15
Compliance with requirements of contract	N	-	0,00	2	184,85	184,85	437,56
Eligibility of expenditures	N	-	0,00	5	1 066,82	1 066,82	22 616,02
Supervision of project implementation	N	-	0,00	1	0,00	0,00	0,00
Total:		5	48,43	18	6 736,90	6 785,33	18 189,85

Accordingly, as result of complementary audit of operations 10 recommendations were issued (detailed summary in *Annex 10*). Deadline of implementation recommendations are not in force at the moment of issuing ACR.

8.1.2. Complementary audit of operations due to follow-up of implementation of ESF Financial engineering instrument.

Within 1 OP (ESF) one activity 1.3.1.2 "Support for self-employment and business start-ups" project No 1DP/1.3.1.2.0/09/IPIA/LIAA/001 have been established to implement Financial engineering instrument. According to national legislation responsible body for the activity is Ministry of Economics, intermediate body is LIDA and final beneficiary is Latvian Mortgage and Land Bank.

The Audit authority has performed complementary audit to follow-up the implementation of the ESF financial instrument in order to obtain reasonable assurance that the expenditures – LVL 23 055 238,00, that been transferred to Latvian Mortgage and Land Bank account for establishment of a Loan Fund, approved by the Certifying Authority and declared to the European Commission, and been audited by Audit Authority in previous reference period are eligible.

The total amount of Loan Fund – LVL 23 055 238,00 was transferred to final beneficiary in 4 payments (see *Table 14*).

Table 14. Loan Fund formation

Number of payment	Date	Year, when expenditures are declared to EC	Payment (LVL)
1	31.08.2009	2009	1 437 500,00
2	26.11.2009	2010	844 000,00
3	22.12.2009	2010	12 033 738,00
4	07.10.2010	2010	8 740 000,00
Total:			23 055 238,00

Payments declared to European Commission are contribution for formation of the Loan Fund, and at the moment of regular audit of operations it was not possible to fulfill all audit procedures, in order to obtain reasonable assurance on eligibility of expenditure. Audit Authority monitors the absorption of payments by complementary follow-up audit to verify expenditures absorbed by beneficiary (Latvian Mortgage and Land Bank submitted interim reports) and approved by LIDA.

In the previous reporting period (01 July 2009 – 30 June 2010) the audit was performed for the 1st interim report with absorbed amount – LVL 226 599,46.

In this reporting period the Audit Authority has performed an audit No AI/SAI-ESF-11/40. Within this audit the interim reports No 2 (period from 01.01.2010 till 30.06.2010) and No 3 (period from 01.07.2010 till 31.12.2010) were selected. Actually audited expenditures are disclosed in Table 15.

Table 15. Expenditures checked

Total certified expenditures	Amount selected for auditing		Actually audited expenditures	
LVL	LVL	%	LVL	%
23 055 238,00	3 201 738,74	13,9	1 679 003,76	7,28

As a result of the complementary follow-up audit, deficiencies in procurement and eligibility of expenditures were detected, and expenditures in amount of LVL 30 154,88

were recognized as ineligible. 2 high priority recommendations were issued during the audit. Deadline of implementation of recommendations are not in force at the moment of issuing ACR.

8.2. Financial engineering instruments special audit

This section of the Annual Control Report contains restricted information that is not publically available.

8.3. The overall level of assurance from the combination of the results of the system audits and audits of operations

The Audit Opinion of the Audit Authority is prepared in accordance to the Commission Regulation No.1828/2006 Annex VII and ISA 800 “Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks”.

The Audit Opinion results from the management and control system audits and audits of operations. The relationship between the management and control system audits and audits of operations that is determined by the Audit Authority is set out in Table 18 below:

Table 18. Preparation of the Audit Opinion

MCS audit results	Materiality level		Systemic error where financial correction can not be prevented	
	Below materiality level < 2%	Above materiality level > 2%	Significant, but not comprehensive	Significant and comprehensive
1	Unqualified opinion	Qualified opinion	-	-
2	Unqualified opinion	Qualified opinion	Qualified opinion	-
3	Qualified opinion	Qualified opinion / Adverse opinion	Qualified opinion / Adverse opinion	Adverse opinion
4	Adverse opinion	Adverse opinion	Adverse opinion	Adverse opinion
Information missing	Disclaimer	Disclaimer	Disclaimer	Disclaimer

8.4. Assessment of the Audit Authority

In the period from 1 January to 30 November 2011 the Audit Authority’s work has been assessed by the externally outsourced auditors, the EC and the European Court of Auditors:

- 1) 12 April 2010 to 16 April 2010 and from 17 to 21 May DG EMPL audit mission A-Rep No 1135 „*Coordination meeting with the Audit Authority pursuant to Articles 62, 72 and 73 of Council regulation (EC) No.1083/2006 – OP Human resources and employment CCI 2007LV051PO001*”.
- 2) “Ernst & Young” Ltd. performed External Quality Assessment of Ministry of Finance as the Audit Authority according to International Audit Standards, report dated 18 January 2011. The assessment is provided in *Annex 1* of the Annual Control Report.
- 3) From 25 to 29 October 2010 DG REGIO performed audit mission No. 2010/LV/REGIO/J2/922/1 „*Review of the work of the Audit Authority 2007-2013*”.
- 4) From 21 February 2011 to 11 March 2011 DG EMPL audit mission „*Review and re-performance of the work of the Audit Authority pursuant to Articles 62, 72 and 73 of Council regulation (EC) No 1083/2006 - OP Human resources and employment CCI2007LV051P0001, Annual Control Report and the Audit Opinion*

submitted on 31/12/2010” (A rep No.1131) where audits of operations were re-performed on 8 projects.

- 5) Two missions regarding assessment of the Audit Authority work were performed in June 2011 by the DG REGIO – No 2011/LV/REGIO/J2/958/1 and No 2011/LV/REGIO/J2/975/1 in order to assess modules 1 – 4.
- 6) From 3 to 7 October 2011 DG REGIO audit mission No.2011/LV/REGIO/J2/976/1 „ERDF and Cohesion Fund - Review of the work of the Audit Authority pursuant to Article 62 of Council regulation (EC) No 1083/2006” to do re-performance of audits of operations financed under the Entrepreneurship and Innovations (CCI No 2007LV161PO001) at the level of the selected bodies involved in the management and control of the funds of the selected operations.
- 7) From 28 November to 3 December 2011 the audit mission by the European Court of Auditors was conducted.

The overall work of the Audit Authority assessed by the DG EMPL and the “Ernst & Young” Ltd. was assessed in category 2 – works, but some improvements are needed.

Audit reports of all other audit missions are under the contradictory procedure and not has been finalised yet.

8.5. Interruption of the interim payments (Article 92 of Regulation No 1083/2006) under Operational Programmes “Entrepreneurship and Innovation” and “Infrastructure and Services”

In accordance with informal information received by Head of Managing Authority from DG REGIO on 15 December 2011 regarding provisional findings of the DG REGIO audit mission No 2010/LV/REGIO/J2/922 on the work of the Audit Authority, the decision by the Head of the Managing Authority was taken to suspend the interim payments of the Operational Programmes “Entrepreneurship and Innovation” and “Infrastructure and Services”.

On the 23 December 2010 the DG REGIO sent draft report of the mission No 2010/LV/REGIO/J2/922 stating its provisional findings (7 findings in total) relating the human resource capacity, quality and reliance of the system audits and audits of operations and the effective functional independence of the Audit Authority. Most of the recommendations were implemented before the Bilateral meeting between Latvia Audit Authority representatives and the EC representatives in Brussels on 14 April 2011. However, on 13 April 2011 the DG REGIO issued a letter on the decision to suspend the interim payments due to significant deficiency in the functioning of the management and control systems within the meaning of the Article 91(1)(a) of Council Regulation (EC) No 1083/2006, justifying an interruption of the payment deadline.

Following the DG REGIO audit mission in June 2011 it was concluded by the EC that the measures taken by the national authorities for the strengthening of the independence of the Audit Authority and the improvement of the quality of the audit work performed to be satisfactory (DG REGIO 4 August 2011 letter No D(2011) 898718) and the interim payments have been renewed under suspended OPs except axis 2 measures of the Operational Programme “Entrepreneurship and Innovation”.

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