

AUDIT AUTHORITY

ANNUAL CONTROL REPORT



IEGULDĪJUMS TAVĀ NĀKOTNĒ

ESF, ERDF, CF

01.07.2013. – 30.06.2014.

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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
DG EMPL	Directorate General Employment, Social Affairs and Inclusion
DG REGIO	Directorate General Regional and Urban Policy
EC	European Commission
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
FEI	Financial Engineering Instruments
IB	Intermediate Body
ISA	International Standards on Auditing
LIDA	Latvian Investment and Development Agency
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
MoE	Ministry of Economics
MoESc	Ministry of Education and Science
MoF	Ministry of Finance
MoH	Ministry of Health
MoT	Ministry of Transport
MoW	Ministry of Welfare
MUS	Monetary Unit Sample
OP	Operational Programme
OPs	Operational Programmes: Infrastructure and Services (No 2007LV161PO002), Entrepreneurship and Innovation (No2007LV161PO001) and Human Resources and Employment (No 2007LV051PO001)
PA	Paying Authority
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 in accordance with 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 2007LV161PO001) and Human Resources and Employment (No 2007LV051PO001) 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 expenditure declared to EC within the period from 1 January to 31 December 2013 (*Section 1.2*).

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

6. The ACR and the 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. During the audit period no significant changes in the management and control system were made (*Section 2*).

8. The Single Audit Strategy was updated and communicated to the EC on 11 July 2014 (*Section 3*).

9. As the result of the management and control system audits performed by the Audit Authority, the Managing Authority is assessed with category 2 - the management and control system of the Managing Authority is determined as working, but some improvements are needed. Deficiencies found have a moderate impact on the functioning of the key requirements/authorities/system. Recommendations have been formulated and most of recommendations were implemented before issuing of Audit Opinion. Certifying Authority is assessed with category 1 – the management and control system within the Certifying Authority works well. Detailed information of the work done regarding management and control system audits is set out in *Section 4*.

10. Error rate identified by the Audit Authority in accordance with the results of the audits of operations is 0,93% that is below the materiality level, thus the expenditure declared to the EC is 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 relay on the work of other auditors in preparation of the ACR (*Section 6*).

12. In total the recommendations have been implemented in accordance with the action plans of the management and control system audits. There are

recommendations that are not entirely implemented, but do not have an impact on the evaluation of the ACR (*Section 7*).

13. In audit reference period the Audit Authority performed one complementary audit of operations due to risky areas identified within regular audits of operations and other sources. Audit approach and results of complementary audits are described in *Section 8.1*.

14. The Audit Authority audited negative amounts declared during year 2013. Audit results are under contradictory procedure (*Section 8.2.*).

15. During the period the Audit Authority performed horizontal system audit "Financial instruments (FEI)" (No SIST-FEI-13/25) that covered all institutions involved in FEI administration – Managing Authority, Certifying Authority, Ministry of Economics and Latvian Investment and Development Agency. The Audit Authority assessed the management and control system of FEI administration and the implementation of recommendations of the previous audit. Audit Authority concluded that the management and control system of FEI is working, but certain improvements are required (Audit report on 18 July 2014) (*Section 8.3.*).

16. The Audit Authority is planning to perform an audit regarding the closure of 2007–2013 programming period and has updated internal procedure for closure of operational programmes (*Section 8.4*).

17. During the period the EC and the European Court of Auditors audits were carried out and the recommendations of the EC audits are being implemented in accordance with the action plan (*Section 8.5*).

18. The Audit Opinion on effective functioning of the management and control system for the reference period from 1 July 2013 to 30 June 2014 and the legality and regularity of the underlying transactions of expenditure declared to the EC in 2013 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 concludes to have an unqualified Opinion as it is set out in *Table 12 and Section 8.6*.

19. In November 2013 the work of the Audit Authority was assessed by DG REGIO. The draft report was received on 28 April 2014. Two findings are still under contradictory procedure and final report is not received yet. On 16 July 2014 the Audit Authority received EC notification under the terms of Article 73(3) of Council Regulation (EC) No 1083/2006 stating reliance on the opinion of the Audit Authority. (*Section 8.7*).

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 501 “Procedures for Ensuring the Functions of the Audit Authority in the Management of European Union Structural Funds and the Cohesion Fund” dated 24 July 2012, the Ministry of Finance fulfils the functions of the Audit Authority.

Based on 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 2007LV161PO001 (2 OP) and “Infrastructure and Services” No 2007LV161PO002 (3 OP).

Functionally and administratively the Head of the Audit Authority is subordinated to the Minister of Finance and has the power to report directly to the Cabinet of Ministers via Minister of Finance as it 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.

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

The random sample was drawn from the expenditure declared to the EC for the period from 1 January 2013 to 31 December 2013 and the actual audit work of audits of operations was carried out between 1 January 2014 and 30 June 2014 in accordance with the Single Audit Strategy updated on 11 July 2014².

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 ACR 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 12-16/5 dated 11 July 2013, since 1 October 2014 replaced with Regulation of the Ministry of Finance No 12-16/11

² The Audit Authority procedure No ARD-4 “Procedure for the Audit Authority to carry out audits of operations of the European Union funds in 2007–2013 programming period” updated on 20 January 2014 and the updates were included in the Single Audit Strategy updated on 11 July 2014.

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
3 OP	<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 6 Co-operation institutions corresponding to the three levels EU fund implementation:

- The 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, as well as supervision over delegated functions;
- Responsible institutions' main tasks include setting up and determining the national legislation for implementation of the activities/subactivities in accordance with 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 statements 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:

Table 2: Institutions involved in the management of EU funds

Operational Programme	Function of	Institution
1 OP	Managing Authority	- Ministry of Finance
2 OP	Paying Authority and Certifying Authority	- State Treasury
3 OP		
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 Development - 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 - Latvian Investment and Development Agency - State Regional Development Agency - Society Integration Foundation
2 OP	Responsible institutions	<ul style="list-style-type: none"> - Ministry of Finance³ - Ministry of Economics - Ministry of Education and Science
	Co-operation institutions	<ul style="list-style-type: none"> - Central Finance and Contracting Agency² - Latvian Investment and Development Agency - State Education Development Agency
3 OP	Responsible institutions	<ul style="list-style-type: none"> - Ministry of Finance² - 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 Agency² - State Education Development Agency

³ Technical Assistance project.

		<ul style="list-style-type: none"> - Latvian Investment and Development 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 Council Regulation No 1083/2006 Article 62 point (1) (d), EC Regulation No 1828/2006 Article 18 point (2) and the Cabinet of Ministers Regulation No 501 “Procedures for Ensuring the Functions of the Audit Authority in the Management of European Union Structural Funds and the Cohesion Fund”. The Audit Authority does not rely on the work of other auditors as its functions are centralized in the Ministry of Finance. The Head of the Audit Authority approves the ACR as authorized by the Ministry of Finance Order No 57 “About the rights of signing the documentation” dated 8 February 2013⁴.

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 2013 to 23 December 2014;
- 2) the results of the audit of operations and complimentary sample for the expenditure declared to the EC within the period from 1 January 2013 to 31 December 2013;
- 3) information from follow-up procedures;
- 4) information from the reports of other auditors.

1.4.2. Key requirements and assessment criteria

In accordance with the Single Audit Strategy 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). System audits cover all involved institutions every year. Scope of each particular audit is determined based on the risk analysis and previous knowledge. 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 before issuing the ACR and Audit Opinion.

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 2013 to 23 December 2014 the management and control system audits have been performed in every institution that

⁴ Replaced with the Ministry of Finance Order No 399 (1 August 2014).

is involved in the management of EU funds (17 in total) assessing all the key requirements that have been defined by the EC assessment criteria.

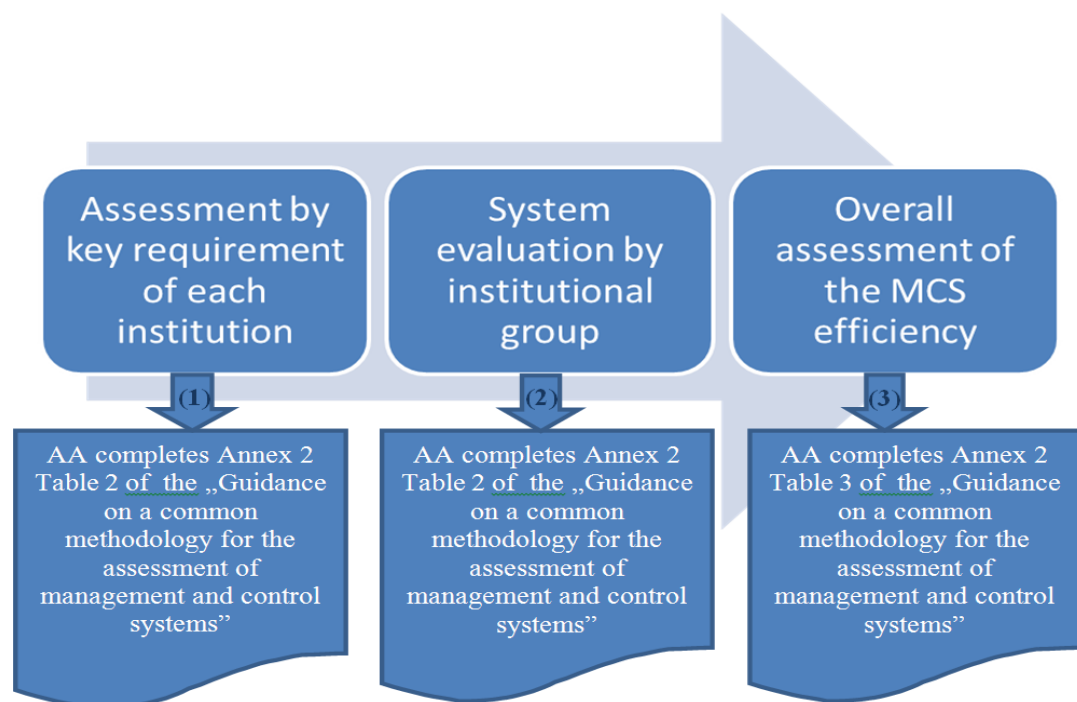
At the planning stage of the management and control system audits the internal control environment of the audited institution is assessed and the main risk factors for each key requirement are determined. In addition, all existing internal controls are identified for the audited institution, whether 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 8 "Procedure on the preparation of the ACR 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 Council Regulation No 1083/2006, EC Regulation No 1828/2006 and EC "Guidance note on annual control reports and opinions".

System Audits:

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 Institutions and 6 Co-operation

institutions. The audit results are summarized in the audit report and highlighted in the cumulative management and control assessment table. Detailed assessment of each key requirement and assessment criteria per institution audited are provided in *Annex 3*.

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.
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 cannot 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 are determined as more 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 highlighted at point 1 (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 the institutions is assessed according to category 3, overall assessment of Managing Authority cannot be higher than category 3 (category 2 or 1). The conclusion of assessment of each institution/authority is summarized in *Annex 4*.

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 5*.

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 4*.

Audits of operations:

In accordance with 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 once 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 expenditure declared to the EC is legal and regular. As a result of the audit of operations regarding any irregular expenditure found, the Audit Authority evaluates the errors, reports to the auditees 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, detailed evaluation is set out in *Table 12 of Section 8.6*.

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 2013 to 30 June 2014 the Managing Authority made one update on 29 October 2014 (changes made till 30 June 2014) to the Management and control description. The changes of the management and control system as compared with the Management and control description have been assessed by the Audit Authority for the period from 1 June 2008 to 30 June 2014. In addition, any post events that have occurred after 30 June 2014 have also been taken into account by the Audit Authority when establishing its conclusions and providing its opinion.

Before issuing the Audit Opinion and ACR, the Audit Authority requests from the Managing Authority a management statement, in which the head of the Managing Authority ensures to the Audit Authority that all significant changes in the management and control system have been communicated to the Audit Authority. Last statement signed by the head of the Managing Authority was received on 19 December 2014.

2.1.1. Changes in the period from 1 July 2013 to 31 December 2013

As reported in the ACR 2013 no significant changes have been made in the management and control system for the period stated above as compared with the Management and control description (updated by the Managing Authority on 30 October 2013 (changes made till 30 June 2013)).

2.1.2. Changes in the period from 1 January 2014 to 30 June 2014, including the events that have occurred after 1 July 2014.

Changes made in the management and control system⁵ are mostly updates of procedures of the Managing Authority and Intermediate bodies and are not considered to be significant. Changes in the procedures are evaluated by the Audit Authority in system audits of institutions and follow-up of the implementation of the recommendations.

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 11 July 2014. The most substantial changes that have been made to the updated Single Audit Strategy are set in points 3.1 – 3.5 below.

⁵ Management and control description updated by the Managing Authority on 29 October 2014 (changes made till 30 June 2014) compared with the Management and control description updated by the Managing Authority on 30 October 2013 (changes made till 30 June 2013).

3.1. During the reference period internal procedure No ARD-4 “Procedure for the Audit Authority to carry out audits of operations of the European Union funds in 2007–2013 programming period” has been updated (on 20 January 2014) including changes in the sampling methodology for audits of operations – standard approach of monetary unit sampling will be applied.

3.2. Starting from 2014 once a year additionally to regular audits of operations the Audit Authority is going to perform audits of negative amounts identified in the expenditure declaration of previous calendar year. Sampling unit for these audits will be the project with negative amount in the expenditure declaration. To determine the units to be audited the Audit Authority will calculate the percentage of projects with negative amounts in each of the operational programs and will respectively determine proportionate number of units in each of the operational programs (not less than 30 units in total).

3.3. In the reference period management and control system audit in the Certifying Authority and Paying Authority will be merged with audit of negative amounts.

3.4. From 1 January 2014 the national currency in Latvia is euro and for conversion from lats to euros fixed exchange rate of 1 euro = 0,702804 lats is used. Hence payments to beneficiaries and recovery of undue payments, amount of irregularities, data collection and error calculation are carried out in euros applying fixed exchange rate.

3.5. During the period starting from 1 July 2014 till 30 June 2015 all of the key requirements will be reviewed in all institutions to be audited by performing only follow-up audits. Additionally the Audit Authority will perform a horizontal audit on readiness of involved institutions for the closure of 2007 – 2013 programming period (*see Section 8.4*).

3.6. The updated management and control system audit plan and the audit approach were presented to the EC during the Bilateral Meeting on 28 April 2014.

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 2013, 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 1 and Annex 2*.

The Audit Authority assessed all institutions that are involved in the management of the EU funds performing 13 audits in total (11 management and control system audits, 2 horizontal system audits) *see Annex 1 and Annex 2*.

Management and control system audits, covering 1 institution per 1 audit, were performed in the following institutions:

- State Education and Development Agency;
- Latvian Investment and Development Agency;
- State Employment Agency;
- Central Finance and Contracting Agency;
- State Regional Development Agency;
- Ministry of Environmental Protection and Regional Development;
- Social Integration Foundation;
- Ministry of Transport;
- Ministry of Finance (the Managing Authority).

According to the Single Audit Strategy the Audit Authority performed 1 follow-up audit covering low risk institutions and institutions where deadlines for implementation of recommendations of previous audits were already in force:

- Ministry of Economics (as Responsible Institution);
- Ministry of Health;
- Ministry of Culture;
- Ministry of Welfare;
- Ministry of Education and Science;
- State Education and Development Agency;
- Latvian Investment and Development Agency.

In order to assess the management and control system in the most efficient way the Audit Authority performed one single audit in the Treasury covering functions of the Certifying Authority and the Paying Authority, and audit of negative amounts.

During the audit reference period the Audit Authority performed 2 horizontal system audits in the area of:

- Irregularities (the Managing Authority, all (14) Intermediate bodies and the Certifying Authority);
- Financial Engineering Instruments (the Managing Authority, 2 Intermediate bodies, and the Certifying Authority).

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

Audits for the reference period were planned according to risk assessment – in total 9 institutions were assessed at high risk and 9 institutions – at low risk. The summary of the risk assessment per OP and per institution for the period from 2013 to 2015 is provided in *Table 4*. The detailed calculations and table of institutions is provided in the Annex 5 of the updated Single Audit Strategy, which was submitted to the EC on 14 June 2013 via SFC2007.

Table 4: Summary of the risk assessment per institution

OP	Institution	Amount of administered EU funding	Total score of risk assessment	Priority
1 OP	MoESc	-	32	Low
	SEDA	236,9 m	38	High
	MoW	-	27	Low
	SEA	241,7 m	38	High
	MoE	-	32	Low
	LIDA	50,9 m	38	High
	MEPRD	-	32	Low
	SRDA	7,2 m	35	Low
	MoF	-	32	Low
	MoH	-	32	Low
	CFCA	34,6 m	35	Low
	SC	-	32	Low
	SIF	11,8 m	35	Low
2 OP	MoESc	-	30	Low
	SEDA	219,1 m	36	High
	MoE	184,3 m	36	High
	LIDA	310,3 m	36	High
	MoF	-	30	Low
	CFCA	23 m	33	Low
3 OP	MoESc	-	32	Low
	SEDA	267,8 m	38	High
	MoE	-	32	Low
	LIDA	201,2 m	38	High
	MEPRD	567,9 m	41	High
	SRDA	310,7 m	38	High
	MoT	1,162 b	41	High
	CFCA	700,5 m	41	High
	MoW	-	27	Low
	MoH	-	32	Low
	MoC	-	32	Low
	MoF	-	32	Low
Managing Authority			39	High
Certifying Authority			29	Low
Paying Authority			29	Low

In general the Responsible Institutions 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, and 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, payment request approval, reporting on irregularities, evaluation of the procurement and publicity requirements which is related to the direct financing of final beneficiaries and consequently with higher risk.

The Audit Authority's general approach according to the Single Audit Strategy in system audits is:

- to assess all institutions that are involved in the management of the EU funds;
- to assess key requirements and criteria with highest risks;
- to assess basic horizontal priorities periodically.

During the audit reference period the Audit Authority performed 2 horizontal system audits in the following areas:

- Irregularities;
- Financial Engineering Instruments (follow-up).

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.



4.4.1. Conclusion reached on the Managing Authority

The Managing Authority of the EU funds for the 2007-2013 programming period is located in the Ministry of Finance and it is responsible for administrating the following functions in accordance with Council Regulation No 1083/2006 Article 60:

- ensuring establishment and implementation of computerized 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's 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 to ensure an adequate audit trail;
- assurance provided to the Certifying Authority (partially);
- compliance with the information and publicity requirements.

During the reference period the Audit Authority performed system audit in the Managing Authority to evaluate improvements made by the Managing Authority in period from 1 October 2012 to 28 February 2014. Audit report was prepared on 16 May 2014 and submitted to the European Commission via SFC 2007.

The Managing Authority is assessed in the category 2 – the management and control system within the Managing Authority works, but some improvements are needed in regards to build up efficiency and quality of supervision of delegated functions:

- ✓ Improvements in monitoring process of project selection stage;
- ✓ Improvements in quality of risk assessment of IB;
- ✓ Improvements in data quality checks to ensure that information in the acknowledgement of the Managing Authority on expenditure declared to EC is accurate;
- ✓ Improvements in planning of remedial actions to ensure preparation of traceable action plan for implementation of recommendations.

In order to conclude on the overall assessment of the Managing Authority, the Audit Authority audited all high risk key requirements of all Intermediate bodies that are implementing the functions delegated by the Managing Authority. The approach of Audit Authority is that the overall assessment of the Managing Authority cannot be higher than the lowest assessment of the institution of its delegated functions.

As it is summarized in *Annex 3* and *Annex 4* 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.

Results of the horizontal system audits are described in detail in *Section 4.4.4*.

4.4.2. Conclusion reached on the Intermediate bodies

As a result of the management and control system audits (see *Annex 3* and *Annex 4*) it is concluded that the management and control system established within the Intermediate bodies is assessed in **the category 2** – is working, but some improvements are needed in regards to quality and scope of management verifications especially:

- insufficient or not timely performed administrative verifications regarding the payment claim or expenditure;
- insufficient public procurement controls;
- insufficient controls of projects/measures physical and financial progress;
- insufficient documentation of controls/control results (audit trail).

More detailed information on the analysis of the errors and findings in order to identify their systemic nature are provided in *Section 4.5*.

4.4.3. Conclusion reached on the Certifying Authority

During the reference period the Audit Authority performed system audit in the Certifying Authority to evaluate improvements made by the Certifying Authority in period from 1 January 2013 to 31 July 2014. Audit report is still under contradictory procedure and will be submitted to the European Commission via SFC 2007 as soon as final report is approved.

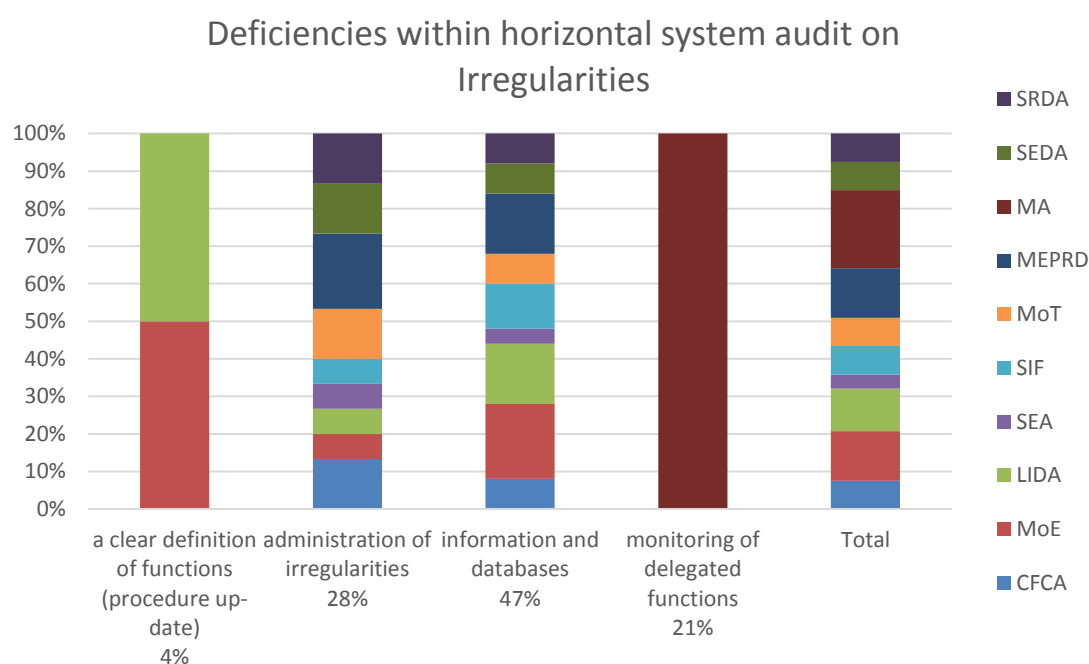
The Certifying Authority is assessed in **the category 1** – the management and control system within the Certifying Authority works well, as the finding regarding the application of the exchange rate in a specific case is not considered to be systemic (evaluation is based on audit draft report, *see Annex 2 Point 2*).

4.4.4. Conclusion reached on the Horizontal Priorities

4.4.4.1. Irregularities

During the reference period the Audit Authority performed horizontal system audit on administration of irregularities, accounting of recoverable and recovered expenditure. It was concluded, that control system regarding administration of irregularities has been set up, and it works. However, some improvements are needed in regards to MIS data quality and application of financial corrections. Overall summary on deficiencies found during horizontal system audit on irregularities is displayed in *Chart 1*.

Chart 1



4.4.4.2. Financial engineering instruments

See detailed information on *Section 8.3*.

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.

In total as a result of system audits the Audit Authority issued 96⁶ recommendations:

- 14 high priority recommendations;
- 74 medium priority recommendations;
- 8 low priority recommendations.

⁶ Date of the audit report before 18 December 2014

Implementation status of issued recommendations in the time of issuing the Opinion and ACR (see *Table 5* and *Chart 2*).

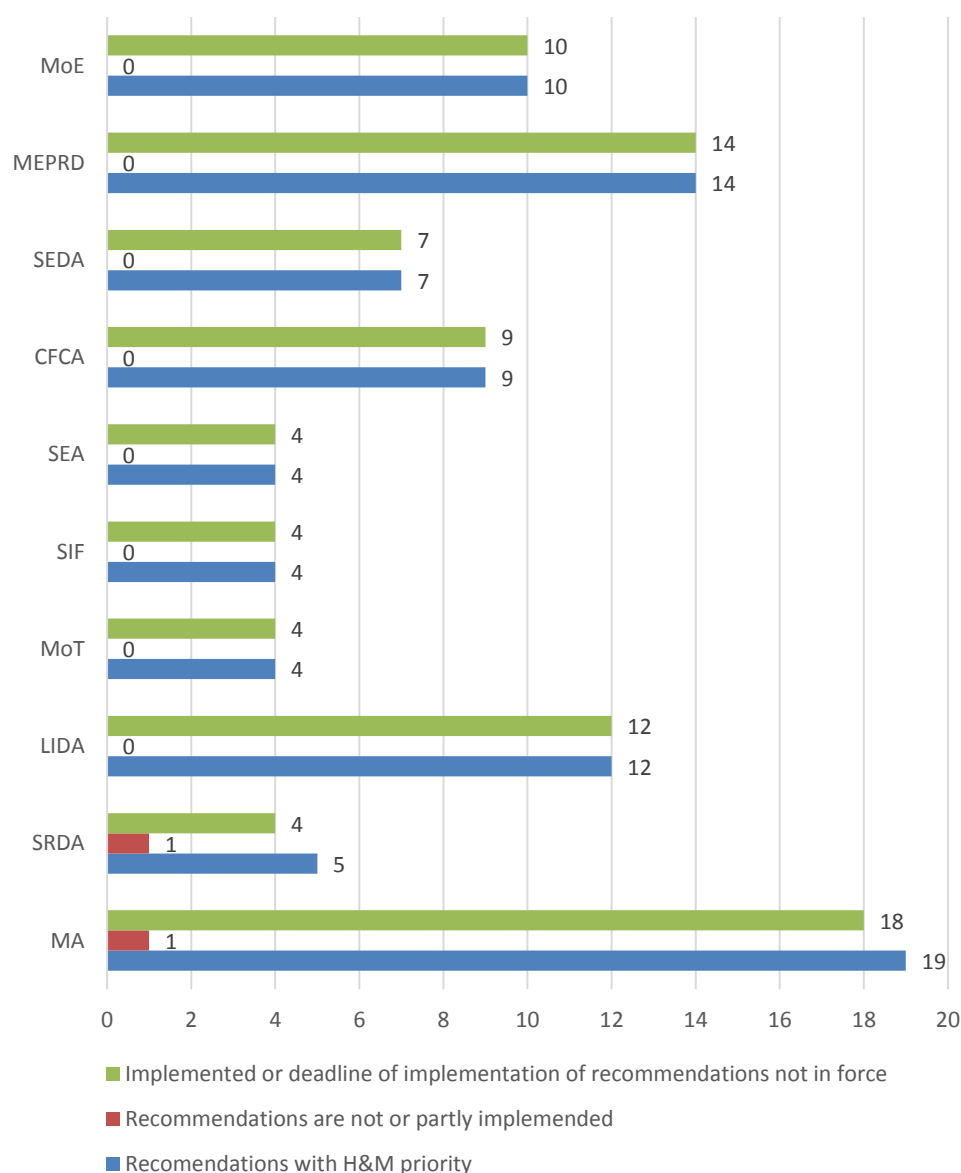
Table 5: Implementation status of issued recommendations

	Recommendations' priority			TOTAL
	High	Medium	Low	
Recommendations implemented	13	68	6	87
The deadline of implementation of recommendations not in force*	1	4	2	7
Recommendations are not implemented	-	2	-	2
TOTAL	14	74	8	96

* in force after 18 December 2014

Chart 2

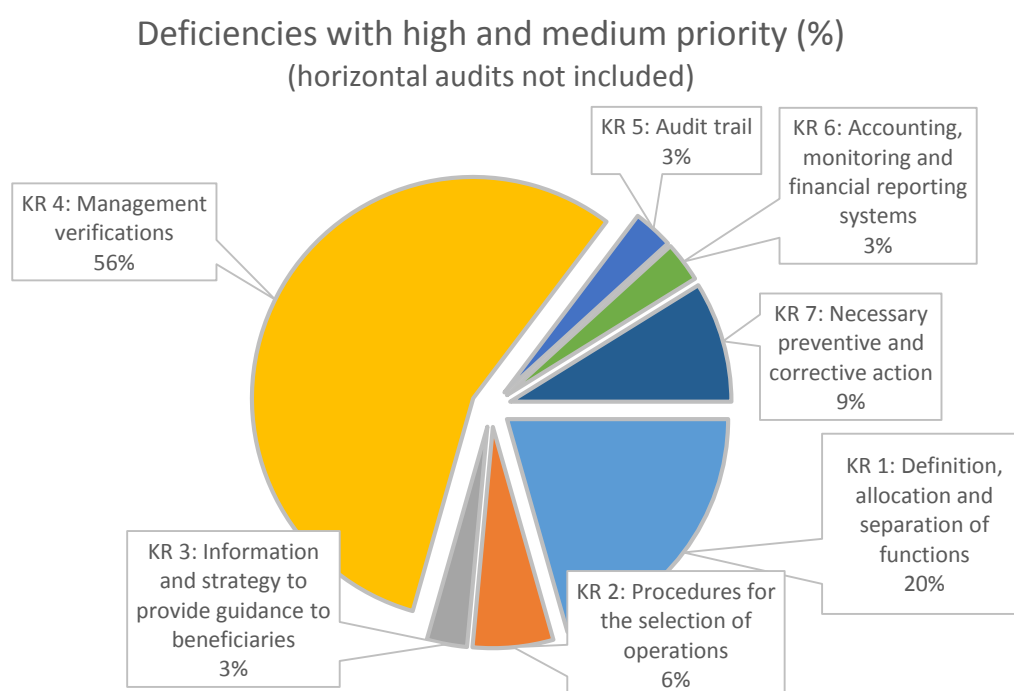
Implementation of recommendations with high and medium priority



Recommendations that are not entirely implemented are described in *Annex 2* and do not have an impact on the evaluation of the ACR.

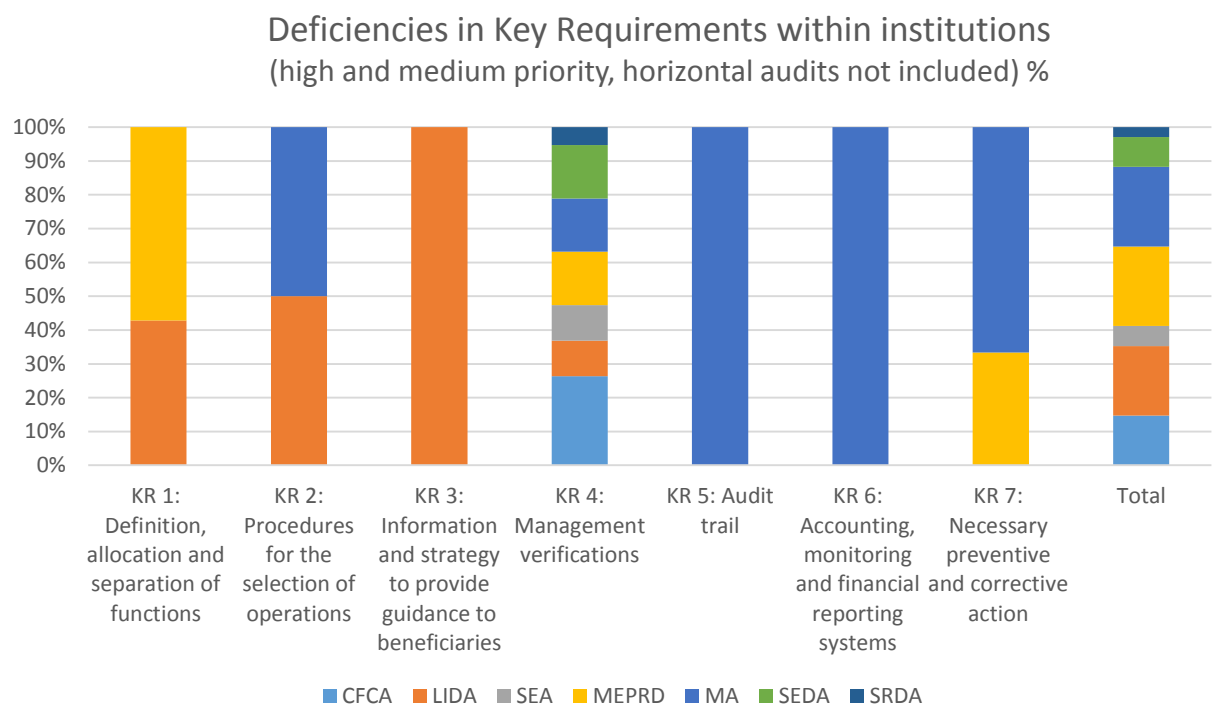
The Audit Authority performed the analysis of the errors and findings in order to identify their systemic nature (we analysed results of audits for which the contradictory procedure was finalized and audit report approved before 18 December 2014, see status in *Annex 2*). As it is shown in *Chart 3* 56 % of all deficiencies identified by the Audit Authority during the system audits were found within Key requirement 4 - Adequate management verifications. According to the Single Audit Strategy system audits were carried out in most risky areas and most risky Key requirements and criteria. Compared to previous period ACR 2013, the proportion of deficiencies found within Key requirement 4 have reduced by 16%, but still more than half of all deficiencies found are within Key requirement 4. Also as it is shown in *Chart 3* 20% of all deficiencies identified were found within Key requirement 1 - Definition, allocation and separation of functions. The Audit Authority identified a capacity risk in regards to management verifications in 2 of 6 Co-operation institutions audited. As current programming period is coming to the end and it is important to have all the resources in place for closure of projects the Audit Authority has indicated the possibility to improve procedures and to allocate resources in the most efficient way.

Chart 3



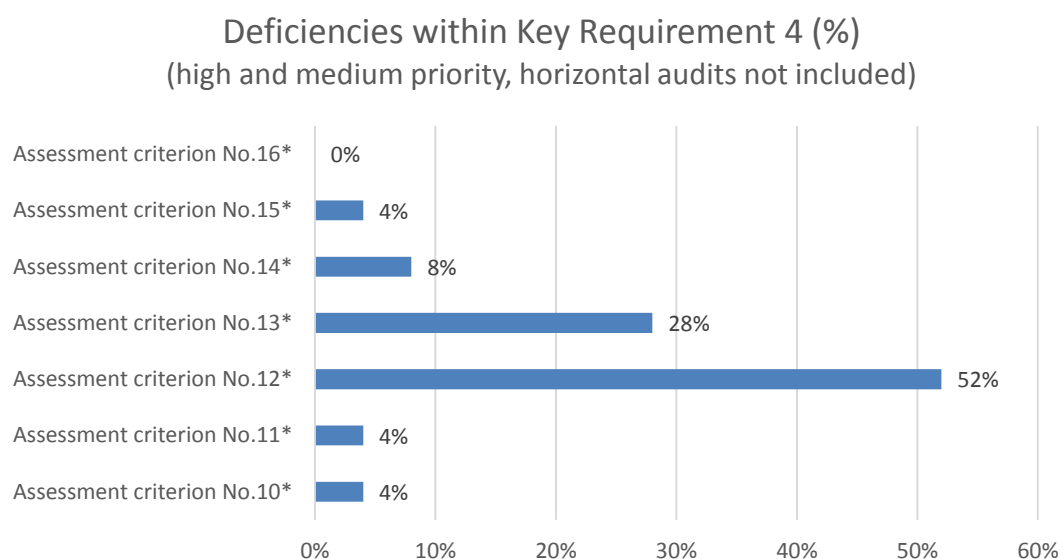
By analysing the results per institution (see *Chart 4*), we can see that out of the 12 respective bodies, deficiencies within Key requirement 4 were found in 7 institutions and 6 of them are Co-operation institutions which perform delegated functions of the Managing Authority regarding management verifications.

Chart 4



Within Key requirement 4 - 52% of all deficiencies identified are related to assessment criteria No 12 (payment claim controls) and 28% are related to assessment criteria No 13 (on-the-spot verifications). As it was mentioned before the approach of the Audit Authority is to assess key requirements and criteria with highest risks and the Audit Authority's system audit results confirmed that improvements are still possible in such high risk areas as management verifications, especially payment claim controls and on-the-spot verifications (see *Chart 5*).

Chart 5



* Detailed criteria descriptions see in *Annex 3*

The Audit Authority performed qualitative evaluation of the deficiencies identified, and consider that (*see Chart 6, Chart 7 and Chart 8*):

- 27% of all deficiencies of management verifications are related to insufficient administrative verifications regarding the payment claims and on-the-spot checks. Shortcomings were found in 4 of 6 Co-operation institutions audited;
- 26% of deficiencies are related to the public procurement controls (3 of 5 irregularities with financial impact which the Audit Authority found during system audits are related to the shortcomings of the public procurement). Shortcomings were found in 3 Co-operation institutions. If comparing with previous period ACR2013 percentage is higher, but total number of shortcomings in the public procurement controls is the same as previous year;
- 11% of deficiencies are related to insufficient documentation of controls/control results (audit trail). Shortcomings were found in 1 Co-operation institution;
- 11% of deficiencies are related to insufficient controls of projects/measures physical and financial progress (1 of 5 irregularities with financial impact which the Audit Authority found during system audits is related to the shortcomings of controls of projects/measures physical and financial progress). Shortcomings were found in 2 Co-operation institutions;
- All other deficiencies are minor and related to such areas as insufficient monitoring of delegated functions, advance payments, information and publicity, data bases, risk assessment, sampling and other.

Chart 6

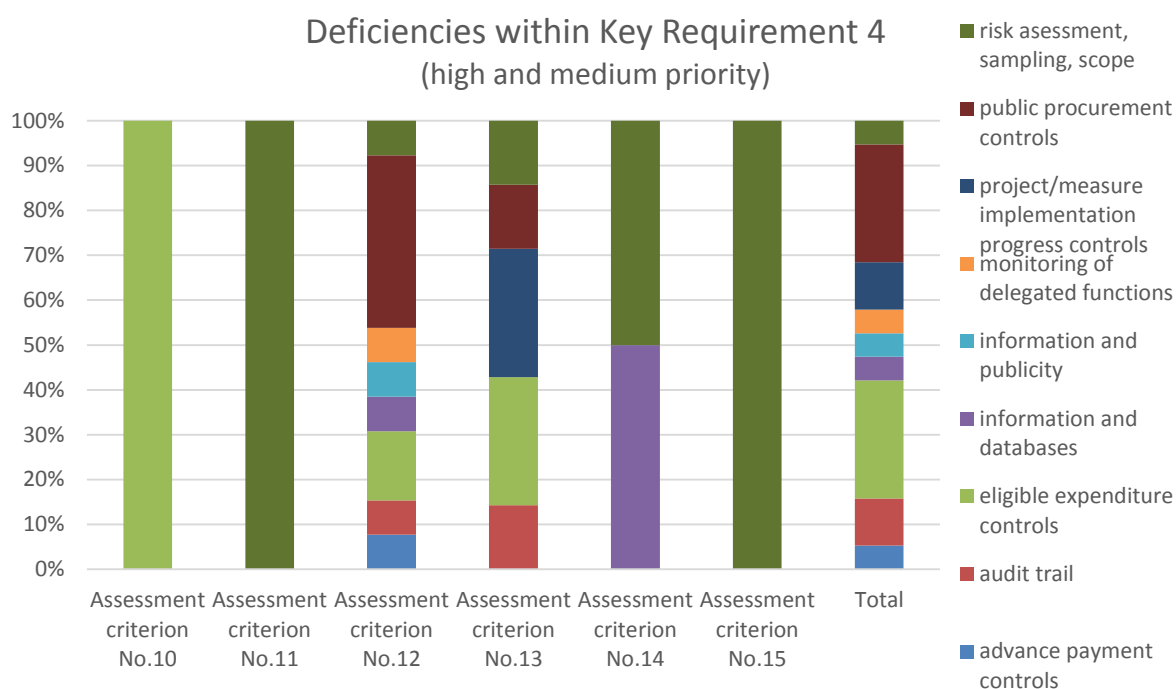


Chart 7

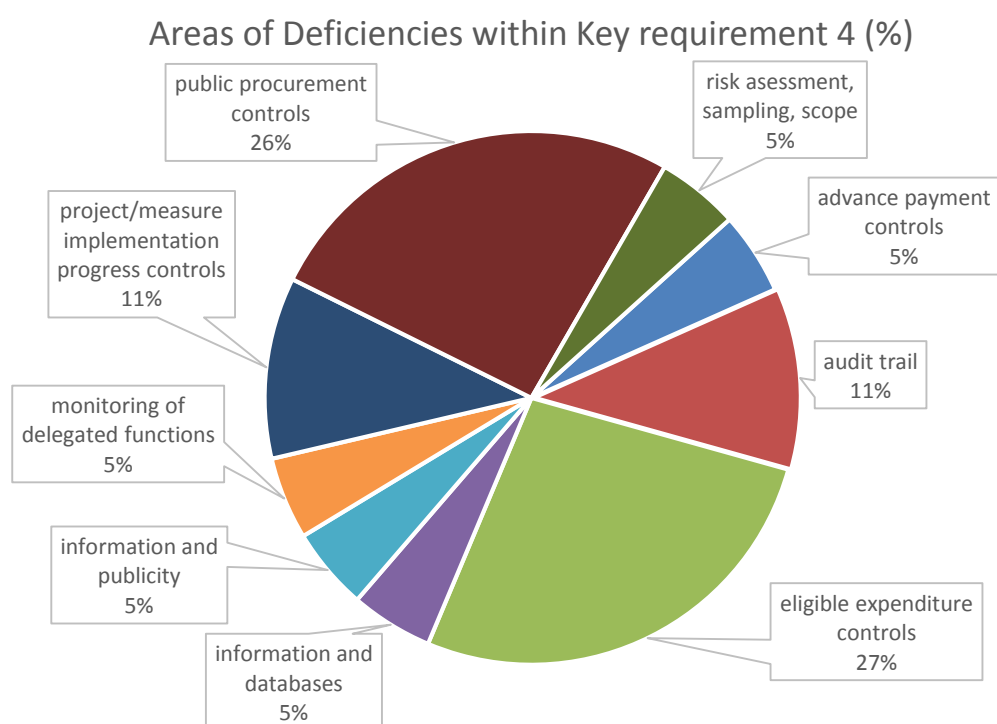
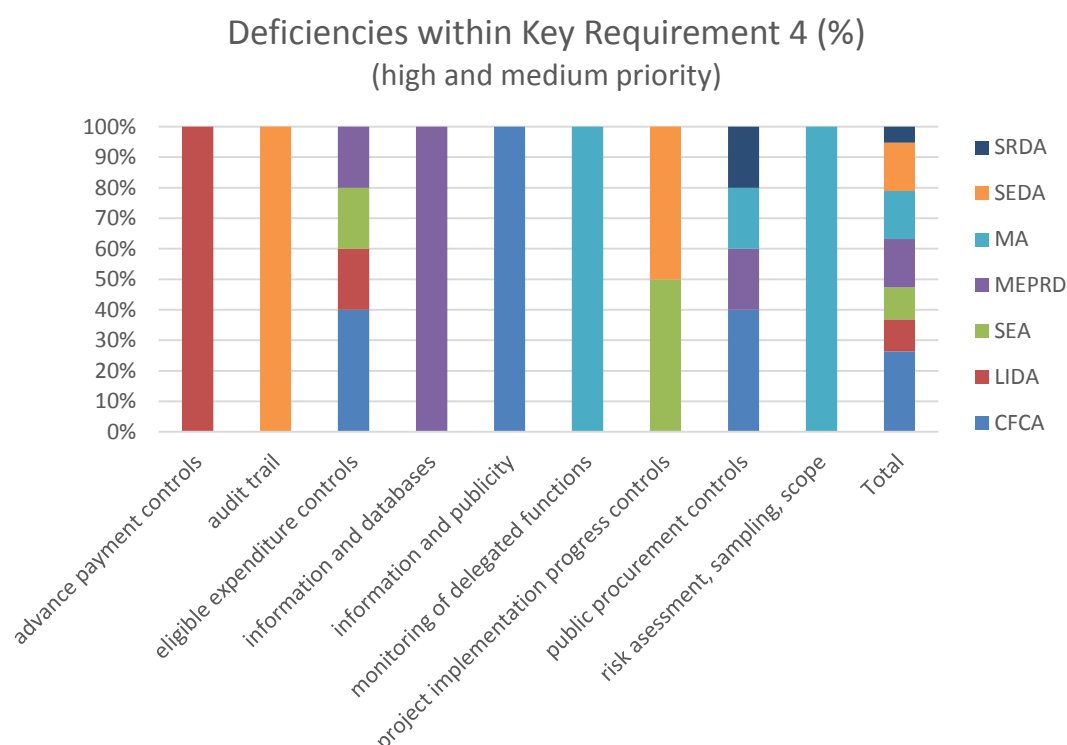


Chart 8



5. AUDITS OF OPERATIONS

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

Audit of operations regarding certified expenditure in calendar year 2013 was carried out by the 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 audit of operations in accordance with Audit Strategy updated on 11 July 2014⁷.

Regular audit of operations is performed for expenditure declared to the EC during the period – from 1 January to 31 December 2013 within all three Operational Programmes:

- 1) Operational programme „Human Resources and Employment” (ESF) – 2007LV051PO001;

⁷ The Audit Authority procedure No ARD-4 “Procedure for the Audit Authority to carry out audits of operations of the European Union funds in 2007–2013 programming period” updated on 20 January 2014 and the updates included in the Single Audit Strategy updated on 11 July 2014.

- 2) Operational programme „Entrepreneurship and Innovations” (ERDF) – 2007LV161PO001;
- 3) Operational programme „Infrastructure and Services” (CF and ERDF) – 2007LV161PO002.

Audit of operations is carried out within the reference period from 1 January to 30 June 2014 for the expenditure declared to EC from 1 January to 31 December 2013 (audit No DR-14/2).

For regular audit one population was formed and one selection was done. Population included certified expenditure of 2013 for all three Operational Programmes.

Sampling unit is a project which payment claim/-s covering eligible expenditure approved by Certifying Authority and included in statements of expenditure submitted to the EC during 2013.

Sampling method was determined according to EC's Guidance on sampling methods for audit authorities (COCOF 08-0021-03-EN) for regular audit. General criteria taken into account for determination of sampling method were number of sampling units in population. For expenditure certified in 2013 population consists of more than 150 sampling units and the sampling method used was statistical sampling – Monetary Unit Sampling (MUS).

Sampling selection parameters⁸ that were used are included in *Table 6*.

Table 6: Parameters used for sampling

Parameters	Value
Assurance from the system	Average
Confidence level	70% ⁹
Book value of expenditure declared (BV)	EUR 936 583 267,07
Materiality level	2%
Tolerable error (TE)	EUR 18 731 665,34
Anticipated error rate	1,06%
Standard deviation of error rates ¹⁰	0,05
Sampling interval	EUR 31 219 442,24
Sample size	2 437 units

From total population of 2 437¹¹ units – projects regarding expenditure declared to EC in year 2013, 30 projects were selected, see *Table 7*.

⁸ All parameters determined according to European Commission Guidance on sampling methods for audit authorities (COCOF 08-0021-03-EN)

⁹ In accordance with the Annual Control Report approved on 19 December 2013 where the opinion of management and control system is provided and evaluated with category 2 „Works, but some improvements are needed”, assurance from the system was Average, so that the confidence level was set 70%.

¹⁰ Based on historical data

¹¹ Total number of payment claims that formed declarations to EC was 6 232. Number of projects that formed population and were used for sampling was 2 437 (5 051 payment claims) because after quality control negative values (recoveries and retroactive payments) were excluded and some payments merged (if the payment for one payment claim was paid in several parts).

Table 7: Expenditure declared during year 2013 and selected units

Population size		Selected sample			Exact verified expenditure		
units	EUR	units	EUR	%	units	EUR	%
Expenditure declared during year 2013							
2 437	936 583 267,07	30	107 811 242,33	11,51	30	102 391 282,73	10,93

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

Results of audits of operations broken down by Operational Programmes are included in *Table 8*.

Table 8: Results of audits of operations

	Certified expenditure (EUR)	Sample (units)	Audited expenditure (EUR)	Irregular expenditure found within sample (EUR)	Error within sample
Expenditure declared during year 2013	936 583 267,07	30	102 391 282,73	1 021 266,88	1,00%
1 OP (ESF)	117 690 966,12	4	9 991 540,13	0.00	0,00%
2 OP (ERDF)	147 273 470,24	7	13 813 014,89	0.00	0,00%
3 OP (CF and ERDF)	671 618 830,71	19	78 586 727,71	1 021 266,88	1,30%

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

As it is stated above for the population of the year 2013 MUS was used according to the EC's guidelines¹². Conclusions were reached in several steps according to internal procedures of the Audit Authority.

Total projected error rate for the expenditure declared within 2013 is set as 0,93%¹³, which does not exceed materiality level – 2%.

Conclusions reached after the qualitative analysis performed are described in *Section 5.4*. All errors found were classified as systemic and random errors and all were included in calculation of total projected error rate. All errors were projected to the population¹⁴. Upper error limit was calculated and set as 1,30%. Further actions taken by the Audit Authority regarding results of regular audits of operations are described in *Section 8.1*.

¹² European Commission Guidance on treatment of errors disclosed in the Annual Control Reports (COCOF_11-0041-01-EN) and the Guidance on sampling methods for audit authorities (COCOF 08-0021-03-EN)

¹³ Taking into account EC DG REGIO finding and view indicated in audit mission No 2013/LV/REGIO/C2/1242/1 concerning potentially unequal treatment of foreign bidders and/or dissuasive effect for foreign bidders Audit Authority during audit of operations identified all similar cases. Financial corrections are not proposed as the relevant finding detected during audit mission No 2013/LV/REGIO/C2/1242/1 is under contradictory procedure (on 12 November 2014 EC letter was received opening the procedure that may lead to financial correction). Audit Authority will take the necessary actions regarding identified cases depending on the EC final decision.

¹⁴ Section 2.6 of the European Commission Guidance on treatment of errors disclosed in the Annual Control Reports (COCOF_11-0041-01-EN)

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 EC Regulation No 1828/2006 results of regular audits of operations provide reasonable assurance that statements of expenditure submitted to the EC for all 3 Operational Programmes are correct and underlying transactions are legal and regular, except in individual cases when deficiencies were identified in fields highlighted in *Table 9*. Total projected error rate for expenditure declared to the EC in year 2013 is 0,93%, and does not exceed materiality level of 2%.

Table 9: 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	0	0	9	9
Random errors				
Procurement	0	0	8	8
Supervision of project implementation	0	0	5	5
Eligibility of expenditure	0	1	2	3
Achievement of the objective of the project/substantial modification	0	0	2	2
Total	0	1	26	27

Detailed qualitative analysis performed on the errors found and their significance is indicated in *Annex 6*.

Further analysis on the systemic errors, their significance and actions taken by the Audit Authority and other institutions is described in the *Section 5.5 and 5.6*.

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

Recommendations regarding findings and errors detected in the regular audit of operations regarding year 2013 and implementation status of those recommendations is summarized in *Annex 7*.

In total as a result of regular audit of operations the Audit Authority issued 17 recommendations¹⁵. Deadline of implementation of recommendations at the moment of preparation of current ACR is not in force yet.

Within the reference period there were no cases of fraud or suspected fraud identified.

The total projected error rate 1,49% indicated in the ACR 2013 has been recalculated and set as 1,16% as it was concluded that one particular error is no more considered as being an error. In the ACR 2013 the Audit Authority indicated that relevant recommendation provided under regular audit of operations as not agreed.

¹⁵ In three cases recommendations were not issued as the necessary corrective measures have already been taken or are in process

As Audit Authority obtained sufficient proof and clarifications from the competent authorities, the relevant finding is cancelled.

According to EC DG REGIO open findings and view indicated in audit mission No 2013/LV/REGIO/C2/1242/1¹⁶ the Audit Authority is requested to recalculate the error rate reported in the ACR 2012¹⁷ and ACR 2013. Taking into account that findings detected during audit mission No 2013/LV/REGIO/C2/1242/1 is under contradictory procedure the Audit Authority will take the necessary actions depending on the EC final decision.

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

The Audit Authority performed qualitative evaluation of the deficiencies identified and considered that several of them are with systemic nature in field of procurement. 9 non-compliances were detected, all of them are with financial impact including non-compliances regarding additional works and restrictive selection criteria.

Breakdown of systemic errors and their financial impact is presented in *Table 10*.

Table 10: Systemic errors

Field of error	1 OP		2 OP		3 OP		Total ineligible expenditure (EUR)	Total ineligible expenditure outside the sample (EUR)
	Number of errors	Ineligible expenditure (EUR)	Number of errors	Ineligible expenditure (EUR)	Number of errors	Ineligible expenditure (EUR)		
<i>I</i>	2	3	4	5	6	7	8	9
Procurement	0	0	0	0	9	398 891,85	398 891,85	1 790 803,46
Total	0	0	0	0	9	398 891,85	398 891,85	1 790 803,46

As a result of deficiencies detected with systemic character that were found during the audit of operations, there are several actions taken by the Audit Authority and other institutions:

1. To eliminate deficiencies in procurement procedures found on the individual project level, recommendations were issued (*see Annex 7*).
2. As it was reported in ACR 2012 and ACR 2013, amendments to Public Procurement Law regarding significant contract amendments came into force on 1 August 2012. As well additional controls (ex-ante checks) for new procurement procedures are in place.
3. Applied requirements (not more than 70% of the total amount of the works to be performed may be transferred to sub-contractors) in procurement documentation and in the national legislation are not in line with the EC public procurement provisions and are considered as restrictive¹⁸. As requirements are in accordance with the national Public Procurement Law in force until 31 July 2012, the irregularity is systemic. The finding detected also during the EC

¹⁶ On 12 November 2014 EC letter was received opening the procedure that may lead to financial correction (audit mission No 2013/LV/REGIO/C2/1242/1)

¹⁷ If one of indicated cases is identified during re-check the operations audited for ACR 2012

¹⁸ Applied for procurements above EU threshold

DG REGIO audit mission No 2014/LV/REGIO/C2/1285/1 and financial correction is proposed¹⁹.

4. Irregularity in procurement procedures found are referable to procurement procedures launched in the period from 2008 till date when amendments to the Public Procurement Law came into force, when previously mentioned (*Point 2 and 3*) actions were not yet implemented.
5. The Audit Authority will follow-up in future reference periods, to ensure that systemic errors within procurement are decreasing and procurement control system is improved and working appropriately.

Regarding additional work performed by Audit Authority, public procurement was one of the main issues of the scope of management and control system audits as well as complementary audit of operations – additional projects were selected and audited (see *Section 8.1.*).

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 ACR 2014 purposes and the Opinion of the Audit Authority as the functions of the Audit Authority are centralized in the Ministry of Finance, the Audit Authority did not rely on the work of internal audit bodies or any other audit 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

Regarding the implementation of recommendations of previous years' system audits it is concluded that institutions that are involved in the management of the EU funds mostly implement the system audit recommendations in accordance with the action plan. However, there are 6 recommendations regarding improvements of Communication Strategy of the MA, implementation of horizontal priority *Equal Opportunities* and some deficiencies within particular construction projects that are not entirely implemented yet. Although, in the AA's system audits performed during the current year AA found that some of the previously issued recommendations are not implemented in practice in sufficient quality. There are also 15 open recommendations that are to be taken in account for the management and control system of 2014-2020 programming period.

Regarding implementation of recommendations of financial engineering instruments system audit see *Section 8.3.*

¹⁹ Audit mission No 2014/LV/REGIO/C2/1285/1 draft report is under contradictory procedure

Regarding implementation of recommendations of audits of operations reported in ACR 2013 – there were 70 open recommendations (*see Annex 8*). One recommendation was cancelled (*see Annex 8, Point 47 and section 5.5.*) .

It was reported in the ACR 2013 that results of one audited project within complementary audit of operations was under contradictory procedure at the moment of preparation of ACR 2013. As a result of contradictory procedure recommendation was issued (*see Annex 8, Point 44*).

At the moment of preparation of current ACR, there are 6 recommendation not yet implemented and 3 partly implemented.

Recommendations that are not entirely implemented do not have an impact on the evaluation of the ACR.

8. OTHER INFORMATION

8.1. Complementary audits of operations

In addition to the regular audit of operations, the Audit Authority in year 2014 performed one complementary audit of operations No PDR-14/13. Following the conditions laid down in the EC's Guidance on sampling methods for audit authorities (COCOF 08-0021-03-EN) section 8.2.1 Audit Authority assessed the sample initially carried out, namely in relation to the results of the risk analysis of each programme and coverage of intermediate bodies audited. As the result of assessment it was concluded that additional work is needed.

Complementary audit No PDR-14/13 has been performed from 14 July 2014 to 5 November 2014 in order reach reasonable assurance whether the results of regular audit of operations and opinion of certain internal control systems remain constant and the expenditure declared to the EC are eligible.

The scope of complementary audit was:

1. Representativeness of the sample

After the assessment of sample of regular audit of operations it was concluded that the coverage of intermediate bodies audited is not representative:

- Projects supervised by Ministry of Economics were not selected, but taking into account, that ministry has declared six payment claims during the year 2013 and four of those were projects under Financial Engineering Instruments, it was decided not to expand the sample as those projects have been audited during the management and control system audit "Financial Instruments" (No SIST-FEI-13/25) (*see Section 8.3.*).
- Projects supervised by Society Integration Foundation were not selected. Society Integration Foundation has declared 390 payment claims (138 projects) during the year 2013. On 16 June 2014 the management and control system audit in Society Integration Foundation (No SIST-SIF-14/12) was launched. The scope of the audit included 4 random selected projects (expenditure declared during the year 2013) which were audited in accordance with procedures of audits of operations (also see *Annex 2 Point 10*).

Thus no additional sample was carried out.

2. Individually risky units/projects:

During the programming period 2007-2013 the Audit Authority receives information about a variety of possible deficiencies within implementation of the EU funded projects (correspondence between the project administrating institutions and other interested parties, including individual complaints and information from media) as to why the projects were considered as high risk projects.

8 projects were audited within complementary audit No PDR-14/13 – for two projects full scope audit was done (12 payment claims) and for 6 projects only risky areas covered²⁰ – for which complaints have been received and the deficiencies were not remedied (no appropriate financial corrections and/or payments recovered). Expenditure of the selected projects was declared to the EC till the end of 2013.

As the result of complementary audit errors in the fields of public procurement, publicity, audit trail and supervision of project implementation were identified.

In one case red flags were identified and information was communicated to the Corruption Prevention and Combating Bureau for the deeper investigation.

3. Projects from risky areas identified:

Taking into account the results of regular audit of operations as well as deficiencies found within management and control system audits, it was concluded that most of the errors and deficiencies were found within projects where final beneficiaries are municipalities.

Taking into account, that audit within the framework of local municipalities projects and major projects are included in the scope of the audit – as individually significant audit units, additional sampling was not carried out.

Breakdown of errors identified in the complementary audit of operations and their financial impact is presented in *Table 11*.

Table 11: Results of complementary audit

Field of error	1 OP		3 OP		1 OP, 2 OP, 3 OP		Total ineligible expenditure	
	Number of errors	Ineligible expenditure in 2013 (EUR)	Number of errors	Ineligible expenditure in 2013 (EUR)	Number of errors	Ineligible expenditure in 2013 (EUR)	In year 2013 (EUR)	Other (EUR)
<i>I</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	3 ²¹	0,00	5 ²²	6 696,32	-	-	6 696,32	12 135,12
Publicity	-	-	1	0,00	-	-	0,00	0,00
Supervision of project implementation	-	-	1	0,00			0,00	0,00
Design of supporting documents	-	-	-	-	1	0,00	0,00	0,00
Total:	3	0,00	7	6 696,32	1	0,00	6 696,32	12 135,12

²⁰ Procurement and/or visit on the site

²¹ Findings from management and control systems audit in Society Integration Foundation No SIST-SIF-14/12 – under contradictory procedure

²² One finding under contradictory procedure

Accordingly, as a result of the complementary audit of operations 7 recommendations were issued (detailed summary in *Annex 9*)²³. Deadline of implementation of recommendations is not in force yet at the moment of preparation of current ACR.

8.2. Audit of negative amounts – recoveries and corrections

The expenditure declared during year 2013 included negative amounts of EUR (65 628 574,82) which constitute a separate population²⁴. From the population – 113 units (negative amounts within 83 projects), 53 negative amounts within 30 projects in total of EUR (61 722 299,42) were selected and audited. During the management and control system audit No SIST-SEI-14/15 Audit Authority verified whether the amount corrected corresponds to what has been decided by the national authorities or the EC.

The draft report contains one preliminary finding regarding the application of the exchange rate which is applicable in a specific case (FEI). The declared amount under discussion is EUR (81 746,01) and does not impact the evaluation of the ACR. Audit results are under contradictory procedure.

8.3. Financial engineering instruments audit

In the programming period several audits regarding the Financial Engineering Instruments were performed by the EC:

- EC fact-finding mission (No 2007LV161PO001) that took place in Latvia from 18 to 19 January 2010 (recommendations issued after this audit were checked in the next audits performed by DG REGIO and DG EMPL and all findings are closed);
- DG REGIO mission (No 2011/LV/REGIO/J2/976/1) in the Audit Authority was held from 3 to 7 October 2011;
- DG EMPL mission (No 2007LV051PO001) in the Managing Authority was held from 5 to 9 December 2011.

In order to implement one of the EC's recommendations formulated in the EC report of the fact-finding mission (No 2007LV161PO001) the Audit Authority performed 2 audits:

- In SIA "Latvian Guarantee Agency" No 2DP/EM/LGA-11/33 (Audit report on 22 July 2011);
- In State joined stock company "Latvian Mortgage and Land Bank" No 2DP/EM/LGA-11/35 (Audit report on 22 July 2011).

In addition the Audit Authority performed two horizontal system audits of Financial Engineering Instruments:

- Audit No 1DP/2DP-EM/LIAA-11/54 (Audit report on 10 December 2012);
- Audit No SIST-FEI-13/25 (Audit report on 18 July 2014).

²³ One recommendation is under contradictory procedure at the moment of preparation of current ACR

²⁴ According to Section 5.5 of the European Commission Guidance on sampling methods for audit authorities (COCOF 08-0021-03-EN)

The audit results and the implementation of the recommendations is summarized further in this section.

8.3.1. DG REGIO Audit of FEI

Work done by the Audit Authority was re-performed by the DG REGIO auditors within mission (No 2011/LV/REGIO/J2/976/1) held in Latvia in October 2011. Draft report was received on 8 June 2012 with 3 recommendations issued for the Audit Authority and the Managing Authority (2 recommendations with high priority). The Audit Authority took immediate actions and reported necessary information to DG REGIO. Final position letter from DG REGIO with proposed financial corrections No FC/LV/REGIO/J2/362 in national language was received by Latvian authorities on 15 March 2013. On the same day Latvia informed the EC about acceptance and application of the proposed financial correction. Financial corrections within 2 activities were applied by the State Treasury: activity 2.2.1.3. (guarantees) and activity 2.2.1.4.1. (loans).

On 13 November 2013 DG REGIO sent a letter (No ARES (2013) 3473549) informing, that after analysing additional information submitted, the Commission accepts the reply of the national authorities and considers all the findings closed.

8.3.2. DG EMPL Audit of FEI

DG EMPL mission regarding FEI (No 2007LV051PO001) in the Managing Authority was held from 5 to 9 December 2011. The Final Report in national language was received by Latvian authorities on 9 October 2013. The Managing Authority reported on elimination of the deficiencies mentioned in the report on 2 December 2013 (letter No 11-2-07/7591) by sending the updated action plan and supporting documents.

Taking into account that all deficiencies were eliminated, on 2 August 2014 DG EMPL sent a letter (No ARES 2815153) to the Managing Authority, informing that the Latvian authorities have accordingly taken into account the recommendations mentioned in the draft audit report and the Commission agrees on the calculation of the financial correction that was submitted by the Managing Authority on 4 July 2013.

8.3.3. Audit Authority's Audit of FEI

From 15 October 2013 to 10 May 2014 the Audit Authority performed horizontal system audit "Financial Instruments" (No SIST-FEI-13/25) that covered all institutions involved in FEI administration – Managing Authority, Certifying Authority, MoE and LIDA. The Audit Authority performed assessment of efficiency of management and control system implemented to administer FEI covering all institutions and financial intermediaries acting in implementation of FEI till 15 October 2013. The audit also covered implementation of recommendations of the previous audit No 1DP/2DP-EM/LIAA-11/54. The audit was performed based on COCOF 2011 Guidance Note on Financial Engineering Instruments (COCOF 10-0014-04-EN).

Audit results – audit report was submitted to the EC via SFC2007 on 22 July 2014. For elimination of deficiencies the Audit Authority issued 6 recommendations, 2 of them were implemented during the audit and 4 of them are implemented

according to the action plan. One of the recommendations was implemented by developing internal rules of Ministry of Economics regarding the winding-up policy. The implementation in practice and the effectiveness of the rules will be checked in future audits of the Audit Authority.

Overall the Audit Authority concluded that the management and control system of FEI is working, but certain improvements are required.

Regarding audit No 1DP/2DP-EM/LIAA-11/54 - 15 recommendations are implemented, 3 recommendations are partially implemented and 1 recommendation is not implemented (implementation period was till 1 April 2013). All of these recommendations are issued to the Latvian Investment and Development agency (LIDA) recommending to improve on the spot checks, traceability of the decision making process, Financial Intermediary control and to strengthen the supervision of issued loans and warranties. LIDA agreed to these recommendations and updated their internal rules, but the supervision of the recommendations issued could have been made only after LIDA performed new on the spot checks (till 17 January 2014 new on the spot checks were not performed by LIDA).

8.4. Closure of 2007–2013 programming period

In 2015 Audit Authority is planning to perform the horizontal management and control system audit regarding the closure of 2007–2013 programming period and on 19 December 2014 the internal procedure ARD-6 “Procedure for the Audit Authority on the closure of the European Union funds in 2007–2013 programming period” was updated. The changes in the procedure are made according to the EC decision of 20 March 2013 on the approval of guidelines on the closure of operational programmes adopted for assistance from the European Regional Development Fund, the European Social Fund and the Cohesion Fund (2007-2013).

8.5. Audits of the European Commission and the European Court of Auditors

8.5.1. During the reference period several audits of previous periods were closed:

1. Final report for the DG REGIO audit mission No 2012/LV/REGIO/J2/1160/1 (22 to 26 October 2012) in order to verify compliance of the EU Regulations requiring satisfactory arrangements for keeping an account of amounts recoverable and for recovery of undue payments (ERDF/ESF) was received on 12 November 2013 stating all findings closed.

2. EC Final Position letter for the DG REGIO audit mission No 2012/LVIREGIO/J2/1158/1 (22 to 26 October 2012) in order to follow-up the action plan implemented in 2012 by the Latvian authorities in order to remedy significant weaknesses in the functioning of the management and control system was received on 6 December 2013 stating that no deficiencies were found and the audit is therefore closed.

3. Closure letter of the three DG REGIO missions (No 2011/LV/REGIO/J2/958/1 (6 to 10 June 2011) No 2011/LV/REGIO/J2/975/1 (27 June to 1 July 2011) and No 2011/LV/REGIO/J2/976/1 (3 to 7 October 2011)) regarding assessment of the Audit Authority work in order to assess modules 1 – 4 was received on 13 November 2013 stating all findings closed.

4. Regarding EC audits on FEI *see Section 8.3.*

8.5.2. During the reference period several audit missions were carried out:

1. DG REGIO audit mission No 2013/LV/REGIO/C2/1285/1 (12 to 16 May 2014) was carried out in order to assess the functioning of management and control system in particular the management verifications as required by article 60(b) of EC Regulation 1083/2006 and articles 13.2 to 13.4 of EC Regulation 1828/2006, with a focus on public procurement (OP Infrastructure and Services (No 2007LV161PO002)). Draft report was received on 29 September 2014 and raised issues regarding Key requirement 4 (Adequate management verifications) concerning the public procurement verifications. Management and control system was assessed - works, but some improvements are needed (Category 2). The comments of the Managing Authority were sent to the EC on 29 October 2014. Final report is not received yet.

2. DG REGIO audit mission No 2013/LV/REGIO/C2/1242/1 (25 to 29 November 2013) was carried out in order to review of the work of the Audit Authority pursuant to Article 62 of Council regulation (EC) No 1083/2006. Draft report was received on 28 April 2014 (national language). Overall, the re-performance of audit work by DG REGIO did not reveal significant deficiencies in the work of Audit Authority (with the exception of findings concerning public procurement issues, which were not considered systematic). Regarding Key requirement No.3: Adequate audits of operations, Audit Authority is evaluated in Category 2 (“Works, but some improvements are needed”). The comments of the Audit Authority were sent to the EC on 29 May 2014. On 12 November 2014 EC letter was received opening the procedure that may lead to financial correction (within one project, covering two EC recommendations that are not accepted yet). Other findings are closed. Final report is not received yet, the Audit Authority is currently working on a response regarding the two open recommendations.

3. European Court of Auditors audit mission (24 to 28 November 2014) was carried out in the Management Authority (DAS 2014) in order to assess the payment made on 16 June 2014 within the Operational Programme Infrastructure and Services (No 2007LV161PO002). Draft report is not received yet.

4. Additionally, the State Audit Office (Supreme Audit Institution of Latvia) performed a parallel audit “Analysis of deficiencies found in the area of public procurements within structural funds programmes” (within the terms of reference of EU Supreme Audit Institution Contact Committee). Audit analyses public procurement irregularities in the period from 2010 to 2013 of Operational Programmes: Infrastructure and Services (No 2007LV161PO002), Entrepreneurship and Innovation (No 2007LV161PO001) and Human Resources and Employment (No 2007LV051PO001). Draft report was received on 28 November 2014

concluding that the EU funds management and control system is detecting irregularities of public procurements. Final report is not received yet.

8.6. 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 EC 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 12*.

Table 12: Preparation of the Audit Opinion

MCS audit results	Materiality level		Systemic error where financial correction cannot 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

The management and control system is assessed in category 2 (*see Section 4 and Annex 5*) and the error rate of the audits of operations is below the materiality level (*see Section 5*), as well based on other information (*see Section 8*) the Audit Authority conclude to issue an Unqualified Opinion.

8.7. Assessment of the Audit Authority

From 25 to 29 November 2013 DG REGIO performed audit mission No 2013/LV/REGIO/C2/1242/1 *Review of the work of the Audit Authority pursuant to Article 62 of Council regulation (EC) No 1083/2006*. Draft report was received on 28 April 2014. Overall, the re-performance of audit work by DG REGIO did not reveal significant deficiencies in the work of Audit Authority and regarding Key requirement No 3: Adequate audits of operations, Audit Authority is evaluated in Category 2 (“Works, but some improvements are needed”). Not all findings are accepted and final report is not received yet. *See Section 8.5.2*.

On 16 July 2014 EC notification under the terms of Article 73(3) of Council Regulation (EC) No 1083/2006 was received stating reliance on the opinion of the Audit Authority for the three Operational Programmes: Infrastructure and Services

(No 2007LV161PO002), Entrepreneurship and Innovation (No 2007LV161PO001), Human Resources and Employment (No 2007LV051PO001).

On 12 September 2014 a contract with SIA “Ernst & Young Baltic” was signed in order to carry out external evaluation (according to International Quality Control Standard) of the Audit Authority. Final report was received on 9 December 2014 concluding the Audit Authority’s compliance with the International Standards on Auditing.

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