

AUDIT AUTHORITY

ANNUAL CONTROL REPORT



IEGULDĪJUMS TAVĀ NĀKOTNĒ

ESF, ERDF, CF

01.07.2012. – 30.06.2013.

Rīga
19.12.2013

TABLE OF CONTENTS

SUMMARY	5
1. INTRODUCTION.....	7
1.1. INDICATION OF THE RESPONSIBLE AUDIT AUTHORITY AND OTHER BODIES THAT HAVE BEEN INVOLVED IN PREPARING THE REPORT	7
1.2. INDICATION OF THE 12 MONTH REFERENCE PERIOD FROM WHICH THE RANDOM SAMPLE WAS DRAWN	7
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	7
1.4. DESCRIPTION OF THE STEPS TAKEN TO PREPARE THE REPORT	9
2. CHANGES IN MANAGEMENT AND CONTROL SYSTEM.....	14
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.	14
3. CHANGES TO AUDIT STRATEGY	15
4. SYSTEM AUDITS	15
4.1. INDICATION OF THE RESPONSIBLE AUDIT AUTHORITY AND OTHER BODIES THAT HAVE BEEN INVOLVED IN PREPARING THE REPORT	15
4.2. SUMMARY LIST OF THE AUDITS CARRIED OUT (BODIES AUDITED).....	15
4.3. DESCRIPTION OF THE BASIS FOR SELECTION OF THE AUDITS IN THE CONTEXT OF THE AUDIT STRATEGY	16
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.....	18
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.....	21
5.AUDITS OF OPERATIONS	27
5.1. INDICATION OF THE BODIES THAT CARRIED OUT THE AUDITS OF OPERATIONS, INCLUDING THE AUDIT AUTHORITY	27
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.....	28
5.3. DESCRIPTION OF THE PRINCIPAL RESULTS OF THE AUDITS OF OPERATIONS.....	29
5.4. CONCLUSIONS DRAWN FROM THE RESULTS OF THE AUDITS OF OPERATIONS WITH REGARD TO THE EFFECTIVENESS OF MANAGEMENT AND CONTROL SYSTEM.....	30
5.5. INFORMATION ON THE FOLLOW-UP OF IRREGULARITIES, INCLUDING REVISION OF PREVIOUSLY REPORTED ERROR RATES.....	31
5.6. PROBLEMS WHICH ARE CONSIDERED SYSTEMIC IN NATURE AND THE MEASURES TAKEN	31

6. COORDINATION BETWEEN AUDIT BODIES AND SUPERVISORY WORK OF THE AUDIT AUTHORITY	33
6.1. DESCRIPTION OF THE PROCEDURE FOR CO-ORDINATION BETWEEN DIFFERENT NATIONAL AUDIT BODIES AND THE AUDIT AUTHORITY ITSELF.....	33
6.2. DESCRIPTION OF THE PROCEDURE FOR SUPERVISION APPLIED BY THE AUDIT AUTHORITY TO OTHER AUDIT BODIES	33
7. FOLLOW UP OF PREVIOUS YEARS' AUDIT ACTIVITY	33
8. OTHER INFORMATION	34
8.1. COMPLEMENTARY AUDITS OF OPERATIONS.....	34
8.2. FINANCIAL ENGINEERING INSTRUMENTS AUDIT	36
8.3. AUDITS OF THE EUROPEAN COMMISSION AND THE EUROPEAN COURT OF AUDITORS.....	37
8.4. THE OVERALL LEVEL OF ASSURANCE FROM THE COMBINATION OF THE RESULTS OF THE SYSTEM AUDITS AND AUDITS OF OPERATIONS	38
8.5. ASSESSMENT OF THE AUDIT AUTHORITY	39
 Annex 1.	Management and Control System Audits from 01.07.2012. to 30.11.2013.
Annex 2.	Management and Control System Audits (and Audit Results) for the Period from 01.07.2012. to 30.11.2013.
Annex 3.	Summary of Assessment by Key Requirement and Assessment Criteria for period from 01.07.2012. to 30.06.2013.
Annex 4.	Assessment of institutions involved in the management of EU funds by the respective key requirement
Annex 5.	Summary of the Management and Control System
Annex 6.	Summary of Errors Broken Down by Operational Programmes
Annex 7.	Summary of Recommendation Provided Under Regular Audits of Operations
Annex 8.	Follow up of Recommendations of Audits of Operations from Previous Reference Periods
Annex 9.	Summary of Recommendations Provided Under Complementary Audits of Operations

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
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) (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 expenditure declared to EC within the period from 1 January to 31 December 2012 (*Section 1.2*).

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

8. The Single Audit Strategy has been updated and communicated to the EC on 14 June 2013 (*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 1,49% 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 management and control system audit plan of implementation of

recommendations. 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, follow-up of advance payments and individually significant units (high risk projects). Audit approach and results of complementary audits are described in *Section 8.1*.

14. The Audit Authority in 2012 performed horizontal system audit "Financial engineering instruments (FEI)" (No 1DP/2DP-EM/LIAA-11/54) that covered all institutions involved in FEI administration – the Managing Authority, Ministry of Economics and Latvian Investment and Development Agency. On 15 October 2013 the Audit Authority started a new audit on FEI activities; implementation of recommendations of the audit No 1DP/2DP-EM/LIAA-11/54 will be checked within the scope of this audit (*Section 8.2*.)

15. Recommendations of the EC audits are being implemented in accordance with the action plan and implementation term (*Section 8.3*).

16. The Audit Opinion on effective functioning of the management and control system for the reference period from 1 July 2012 to 30 June 2013 and the legality and regularity of the underlying transactions of expenditure declared to the EC in 2012 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 8.4*.

17. On 13 November 2013 the Audit Authority received the Closure letter on the DG REGIO audit "Review of the work of Audit Authorities". In November 2013 the work of the Audit Authority has been assessed by DG REGIO within the next audit mission. The draft report is not received yet (*Section 8.5*).

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 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. According to the Regulation of Ministry of Finance the Audit Authority is administratively subordinated to the State Secretary of the Ministry of Finance.

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 2012 to 31 December 2012 and the actual audit work of audits of operations was carried out between 1 July 2012 and 30 June 2013 in accordance with the Single Audit Strategy updated on 26 June 2012.

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:

Table 1: Operational Programmes and respective funds

Operational Programme		EU Fund
1 OP	<i>Human Resources and Employment</i>	ESF

¹ Regulation of the Ministry of Finance No 12-16/7 dated 1 June 2011, and since 11 July 2013 replaced with Regulation of the Ministry of Finance No 12-16/5.

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 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 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 Finance² - 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 - Latvian Investment and Development Agency - State Regional Development Agency

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

² Technical Assistance project.

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 288 “About a circulation of documentation” dated 1 July 2011³.

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 2012 to 28 October 2013;
- 2) the results of the audit of operations and complimentary sample for the expenditure declared to the EC within the period from 1 January 2012 to 31 December 2012;
- 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.

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 2012 to 28 October 2013 the management and control system audits have been performed in every institution (except Paying Authority) that is involved in the management of EU funds (16 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

³ Replaced with the Ministry of Finance Order No 57 (8 February 2013) and Order No 413 (2 October 2013) „About the rights of signing the documentation”.

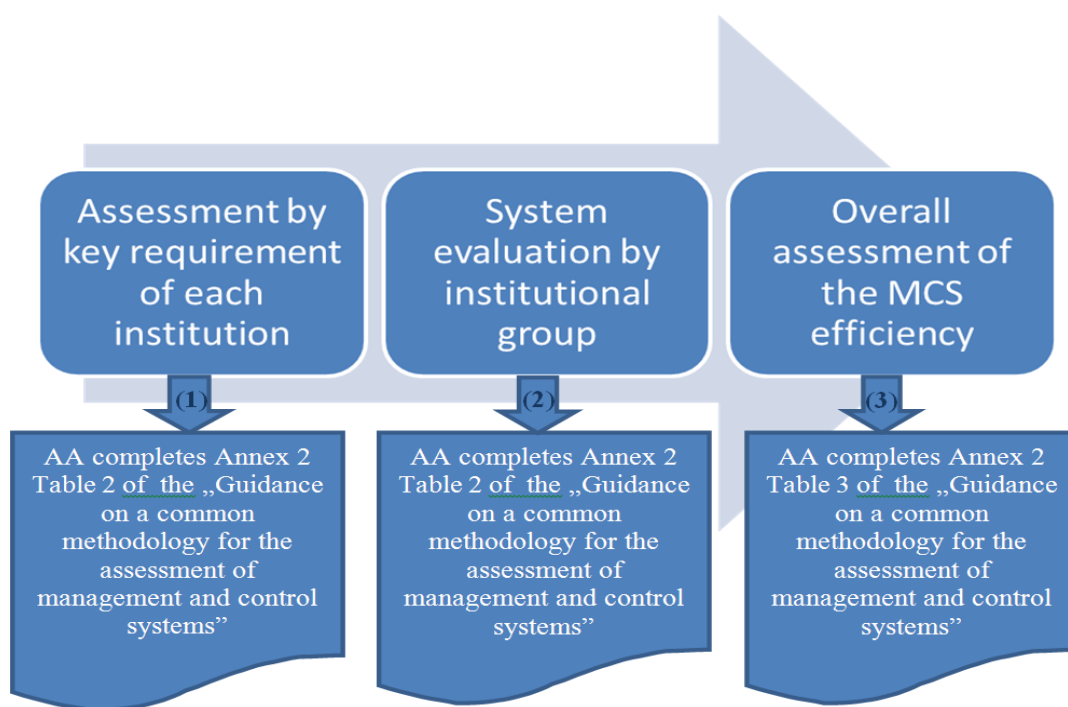
sufficient to reduce the risks. The actual controls are tested and results assessed within the course of the audit.

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 5*.

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 8.4*.

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 2012 to 30 June 2013 the Managing Authority made one update on 30 October 2013 (changes made till 30 June 2013) 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 2013. In addition, any post events that have occurred after 30 June 2013 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 18 December 2013.

2.1.1. Changes in the period from 1 July 2012 to 31 December 2012

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 2012 (changes made till 30 June 2012)).

2.1.2. Changes in the period from 1 January 2013 to 30 June 2013, including the events that have occurred after 1 July 2013.

Changes made in the management and control system⁴ are mostly updates of procedures of the Managing Authority and Intermediate bodies and are not considered to be significant.

The most significant change in the management and control system was made within the Managing Authority. Cabinet Regulation No 524 was amended on 10 September 2013 in order to enhance the ability of the Managing Authority promptly to identify risks due to changes made by Intermediate bodies to management and control system. Cabinet Regulation stipulates that an Intermediate body must obtain an ex-ante agreement from the Managing Authority for every significant change within the Intermediate body.

Changes in the Managing Authority were evaluated by the Audit Authority in the follow-up of the implementation of the recommendations of the Managing Authority.

⁴ Management and control description updated by the Managing Authority on 30 October 2013 (changes made till 30 June 2013) compared with the Management and control description updated by the Managing Authority on 30 October 2012 (changes made till 30 June 2012).

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 14 June 2013. The most substantial changes that have been made to the updated Single Audit Strategy are set in points 3.1 – 3.5 below.

3.1. The Audit Authority has updated the sampling methodology for audits of operations according to the EC's Guidance note on sampling methods for Audit Authorities (COCOF 08/0021/03-EN). The Audit Authority will apply conservative approach of monetary unit sampling and has excluded from the sampling methodology requirements for sampling if the population is less than 800 units.

3.2. Management and control system audits will be carried out in the high risk institutions, but in low risk institutions the Audit Authority will perform follow-up audits. Towards the closure of 2007 – 2013 programming period the Audit Authority will concentrate on evaluation of financial acquisition and readiness of involved institutions for the closure of the programming period.

3.3. During the reference period following internal procedures have been updated:

3.3.1. 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" on 15 January 2013;

3.3.2. Internal procedure No ESFRD-8 (previously – Nr.ARD-26) "Procedure on the preparation of the ACR of the European Union funds in the 2007 – 2013 planning period" on 23 November 2012.

3.4. During the reference period internal procedure No ESFRD-5 „Procedure for the Audit Authority to perform fraud risk assessment within system audits of the European Union funds in 2007–2013 programming period" has been developed on 12 September 2012.

3.5. The updated management and control system audit plan and the audit approach were presented to the EC during the Bilateral meeting on 10 June 2013.

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 2012, 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 16 audits in total (13 management and control system audits, 3 horizontal system audits) *see Annex 1 and Annex 2*.

In order to assess the management and control system in the most efficient way and to cover all key requirements, some system audits were performed to cover the Responsible institution and its respective Co-operation institution in one single audit:

- Ministry of Education and Science, and State Education and Development Agency;
- Ministry of Welfare and State Employment Agency;
- State Chancellery and Social Integration Foundation.

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

- State Regional Development Agency,
- Latvian Investment and Development Agency,
- Central Finance and Contracting Agency,
- Ministry of Environmental Protection and Regional Development.
- Ministry of Finance (the Managing Authority),
- The Treasury (the Certifying Authority),
- Ministry of Transport,
- Ministry of Economics,
- Ministry of Health,
- Ministry of Culture,

According to the Single Audit Strategy – during the audit reference period the Audit Authority performed 3 horizontal system audits in the area of:

- Environmental Requirements (the Managing Authority and (10) Intermediate bodies)
- Equal Opportunities (the Managing Authority and all (14) Intermediate bodies)
- Publicity and Communication (the Managing Authority and all (14) Intermediate bodies).

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

As a result of the 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 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
	MoEcon	-	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
2 OP	SIF	11,8 m	35	Low
	MoESc	-	30	Low
	SEDA	219,1 m	36	High
	MoEcon	184,3 m	36	High
	LIDA	310,3 m	36	High
	MoF	-	30	Low
3 OP	CFCA	23 m	33	Low
	MoESc	-	32	Low
	SEDA	267,8 m	38	High
	MoEcon	-	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.

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 3 horizontal system audits in the following areas:

- Environmental Requirements;
- Equal Opportunities;
- Publicity and Communication.

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 April 2012 to 30 September 2012. Audit report was prepared on 1 February 2013 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 of supervising of delegated functions:

- ✓ Improvements in verifications of delegated functions at the level of IB and final beneficiary.
- ✓ Improvements in risk assessment at the level of IB and project level.
- ✓ Improvements in statement of assurance about controls performed by Managing Authority and submitted to the Certifying Authority (monthly and bi-annually).

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 administrative verifications regarding the payment claim or expenditure;
- insufficient documentation of controls/control results (audit trail);
- insufficient / not well described sampling methods of operations selected.

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 April 2012 to 30 November 2012. Audit report was prepared on 18 February 2013 and submitted to the European Commission via SFC 2007.

The Certifying Authority is assessed in **the category 1** – the management and control system within the Certifying Authority works well.

4.4.4. Conclusion reached on the Horizontal Priorities

4.4.4.1. Environmental Requirements

During the reference period the Audit Authority performed horizontal system audit on the environmental requirements within EU funds. It was concluded, that control system regarding environmental requirements has been set up, and it works. However, in the next programming period 2014 to 2020 improvements could be made in the planning stage of EU funds (impact and result indicators should be defined more precisely) and also in the implementation stage of EU funds (the monitoring and storage of the data of impact indicators).

4.4.4.2. Equal Opportunities

During the reference period the Audit Authority performed horizontal system audit on the equal opportunities within EU funds. As a result of the horizontal system audit it is concluded that control system regarding equal opportunities has been set up, and it works. However, in the next programming period 2014 to 2020 improvements could be made regarding:

- determination of impact and result indicators,
- the monitoring and storage of the data;
- supervision of delegated functions on implementation requirements of equal opportunities;
- the project applications checks and on-the-spot verifications of projects on the requirements of equal opportunities.

4.4.4.3. Publicity and Communication

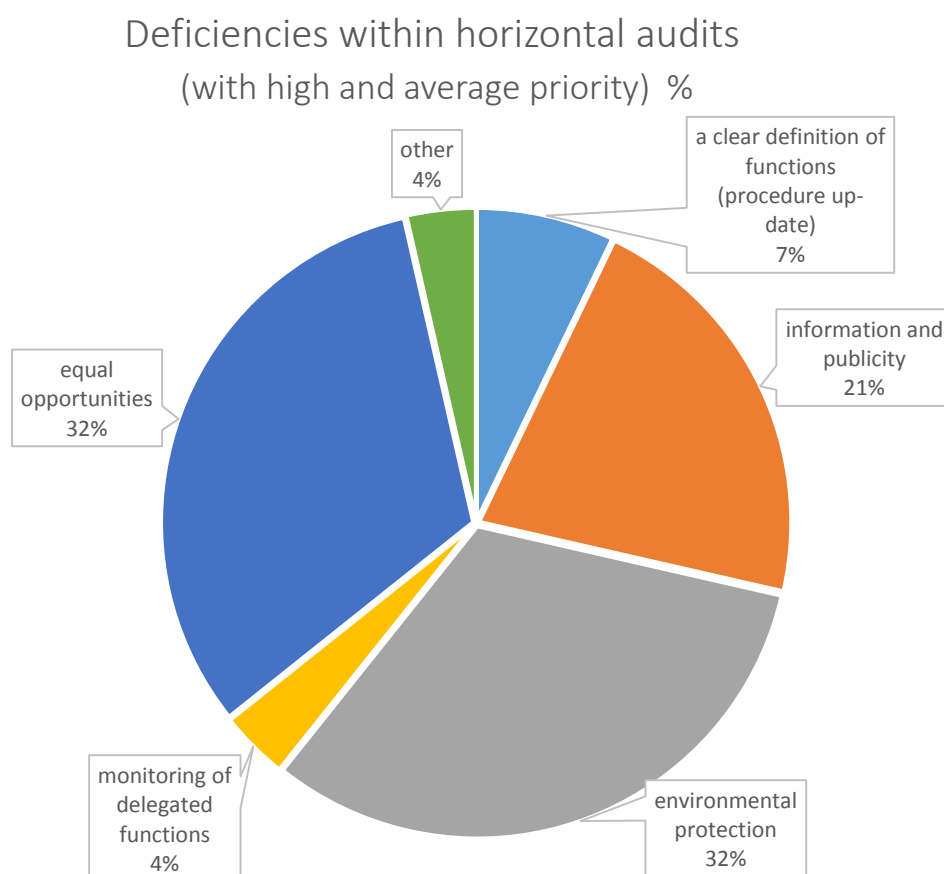
During the reference period the Audit Authority performed horizontal system audit on the publicity and communication within EU funds. As a result of the horizontal system audit it is concluded that control system regarding publicity and communication has been set up, and it works. However, some improvements could be made regarding:

- determination of impact and result indicators;
- supervision of delegated functions on implementation of publicity and communication activities;

- capacity building to ensure implementation of all planned publicity and communication activities.

Overall summary on deficiencies found during horizontal system audits are displayed in *Chart 1*.

Chart 1



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 120 recommendations:

- 15 high priority recommendations (51% less than in the previous period ACR 2012);
- 73 average priority recommendations;
- 9 low priority recommendations (57% less than in the previous period ACR 2012);
- 23 recommendations for next 2014-2020 programming period.

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

Table 5: Implementation status of issued recommendations

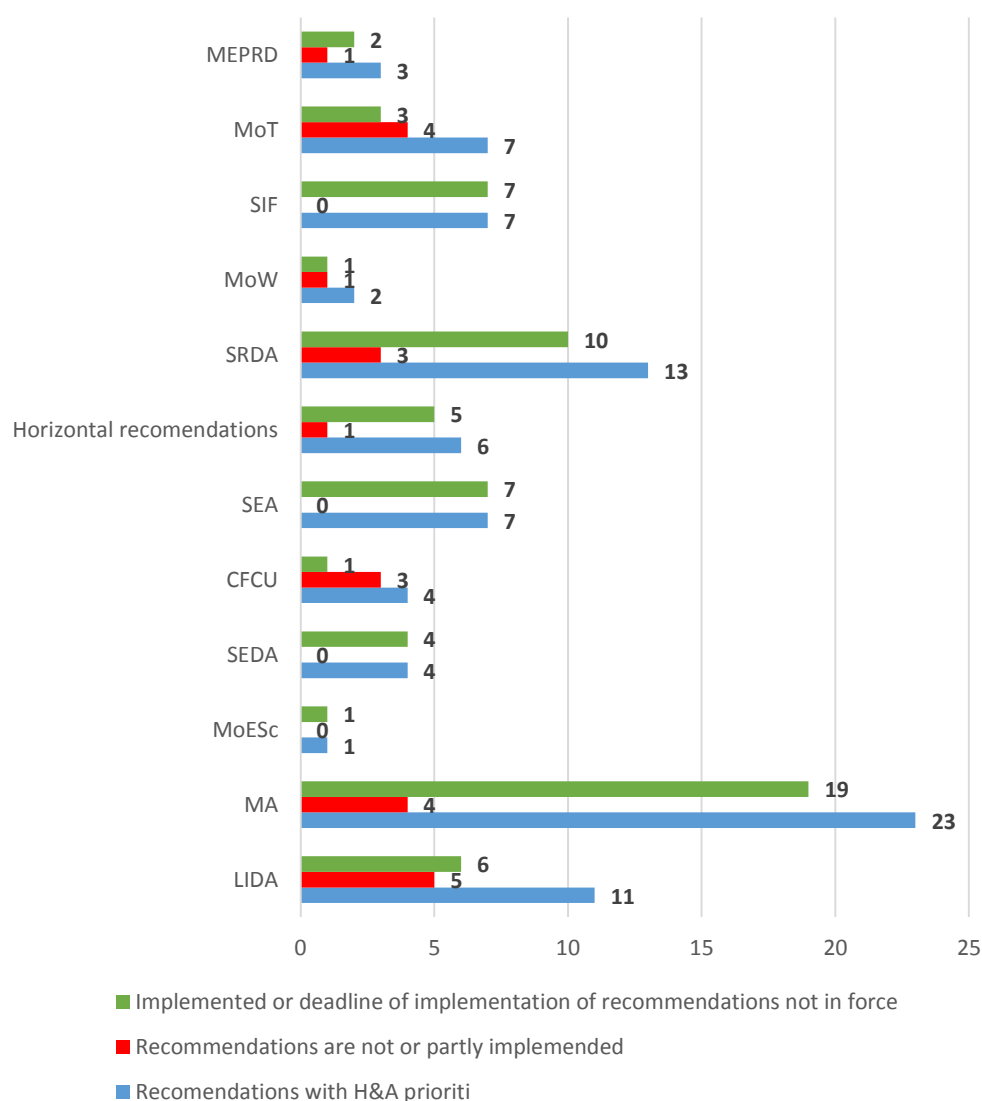
	Recommendations' priority				TOTAL
	High	Average	Low	Other*	
Recommendations implemented	9	52	7	-	68
Recommendations partly implemented	4	4	-	-	8
The deadline of implementation of recommendations not in force**	-	5	2	23	30
Recommendations are not implemented	2	12	-	-	14
TOTAL	15	73	9	23	120

* for 2014-2020 programming period

** in force after 15 November 2013

Chart 2

Implementation of recommendations with high and average priority

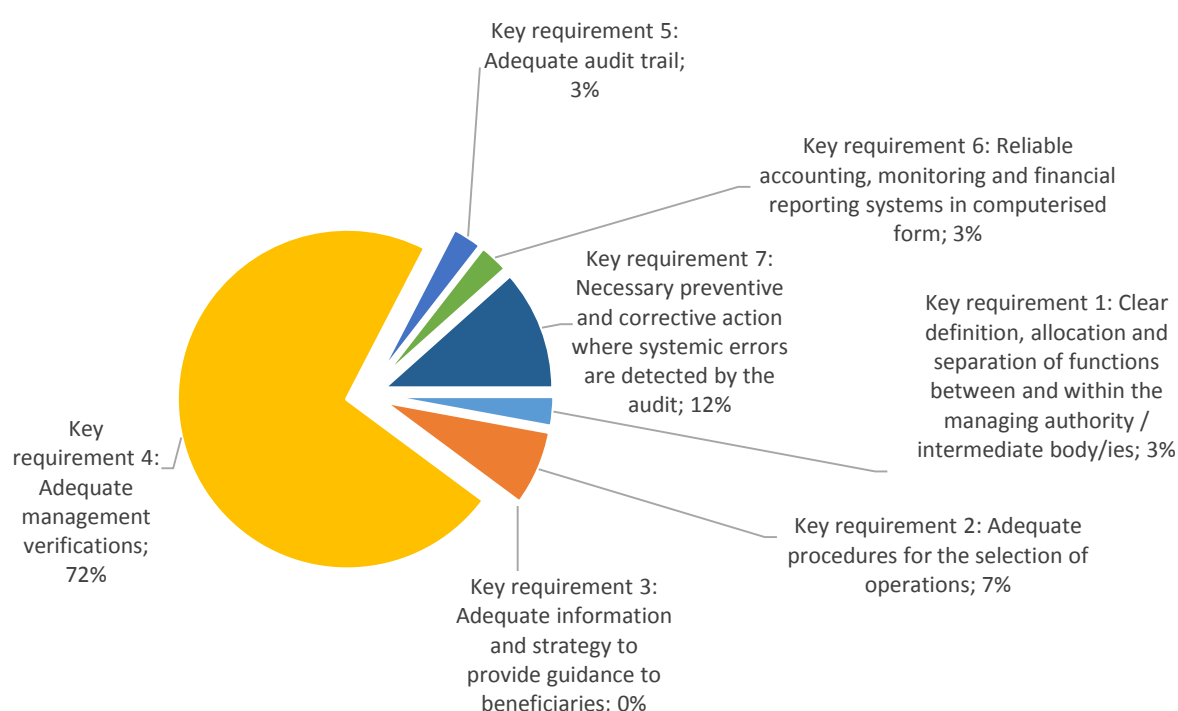


Recommendations that are not entirely implemented are described in *Annex 2* and do not have an impact on the evaluation of the ACR.

The Audit Authority performed the analysis of the errors and findings in order to identify their systemic nature. As it is shown in *Chart 3* 72 % of all deficiencies identified by the Audit Authority during the system audits are identified 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 2012, results are very similar when almost 70% of all deficiencies were found within Key requirement 4.

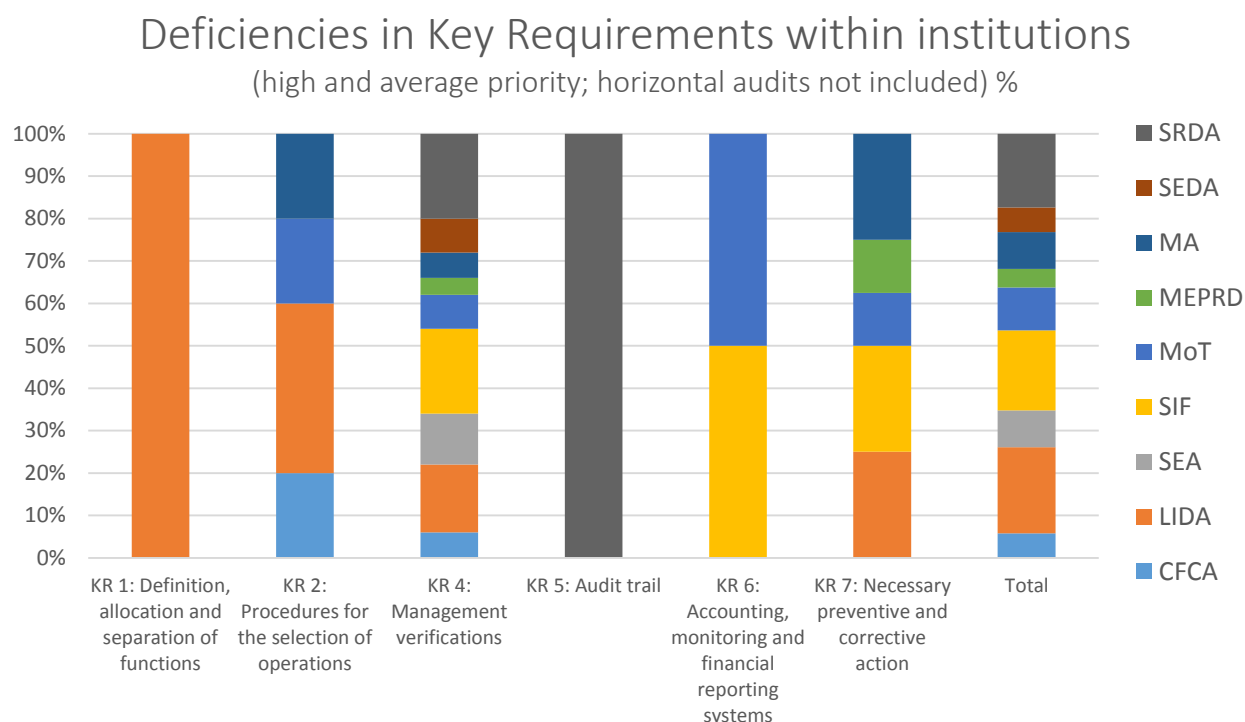
Chart 3

Deficiencies with high and average priority (%) (horizontal audits not included)



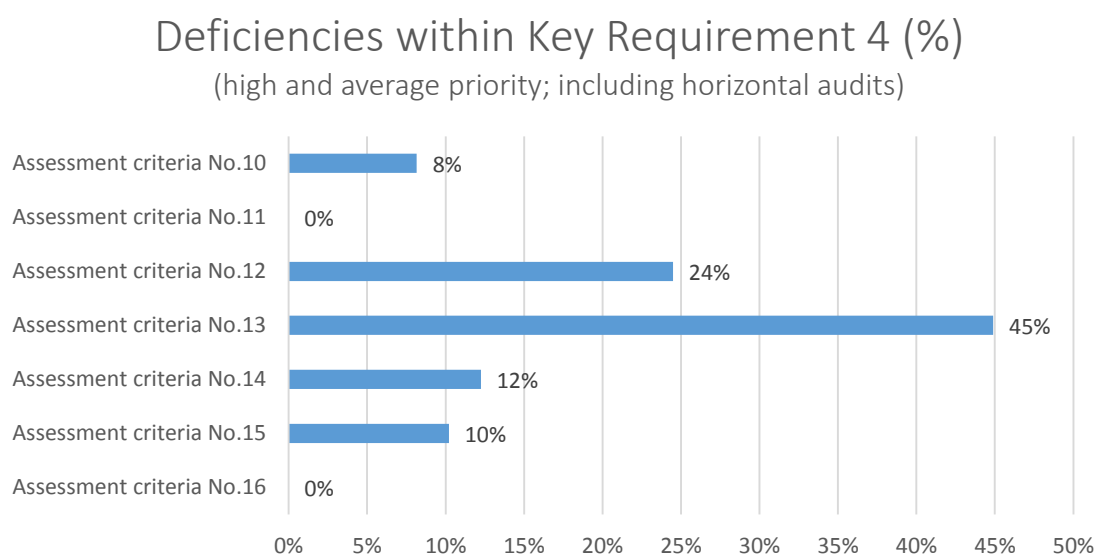
By analyzing the results per institution (see *Chart 4*), we can see that out of the 16 audited bodies, deficiencies within Key requirement 4 were found in 9 institutions and 8 of them are Co-operation institutions which perform delegated functions of the Managing Authority regarding management verifications.

Chart 4



Within Key requirement 4 - 45% of all deficiencies identified are related to assessment criteria No 13 and 24% are related to assessment criteria No 12. 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



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

- 32% of all deficiencies of management verifications are related to insufficient administrative verifications regarding the payment claims (3 of 9 irregularities with financial impact which the Audit Authority found during system audits are related to the shortcomings of payment claim controls). Shortcomings of payment claim controls were found almost in all Co-operation institutions;
- 20% of deficiencies are related to insufficient/not well described sampling methods of operations selected, as well as risk assessment of projects. Shortcomings were found in 5 Co-operation institutions and basically are related to the sampling of operations within on-the-spot verifications of project;
- 12% of deficiencies are related to insufficient documentation of controls/control results (audit trail). Shortcomings were found in 5 Co-operation institutions;
- 10% of deficiencies are related to the public procurement controls (5 of 9 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. However, the Audit Authority would like to stress the positive tendency on improvements in management control system regarding public procurement controls. In previous period ACR2012 32% of all deficiencies regarding the management verifications were related to the public procurement controls;
- 8% of deficiencies are related to insufficient controls of projects/measures physical and financial progress. (1 of 9 irregularities with financial impact which the Audit Authority found during system audits are related to the shortcomings of controls of projects/measures physical and financial progress). Shortcomings were found in 3 Co-operation institutions.
- All other deficiencies are minor and related to such areas as insufficient monitoring of delegated functions, advance payments, state aid rules, double financing and other.

Chart 6

Deficiencies within Key Requirement 4

(high and average priority)

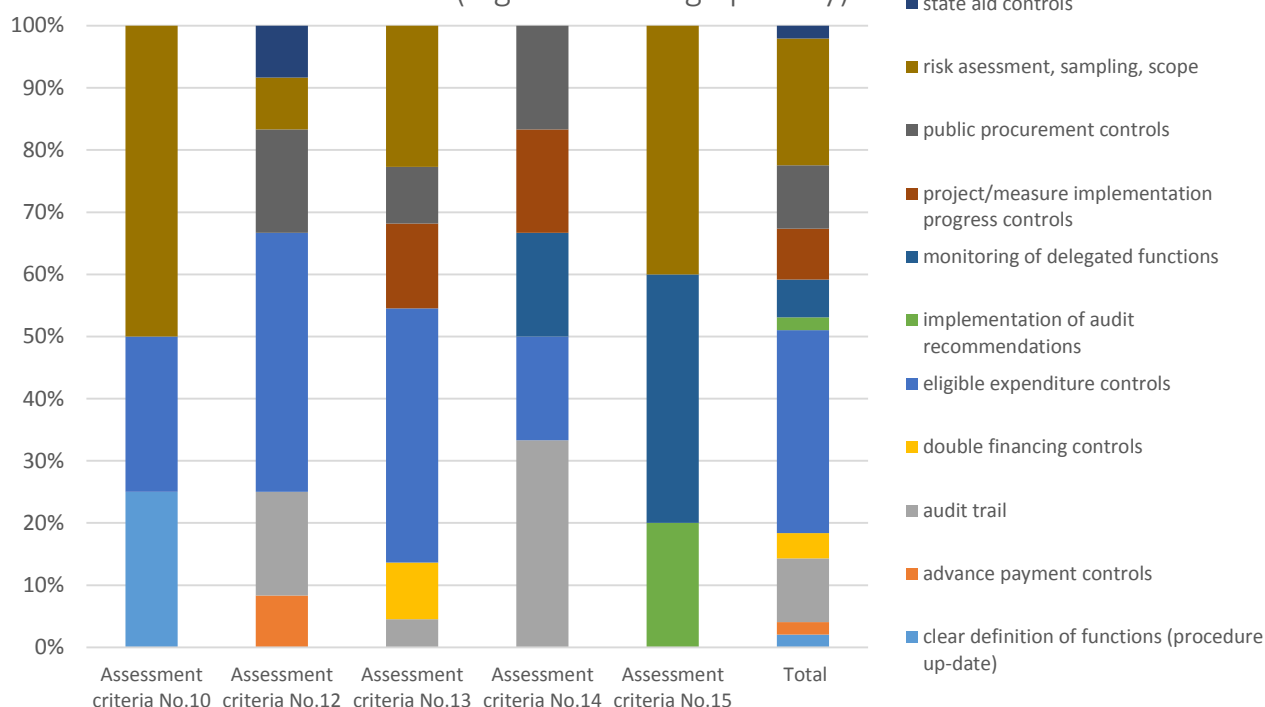


Chart 7

Areas of Deficiencies within Key Requirement 4

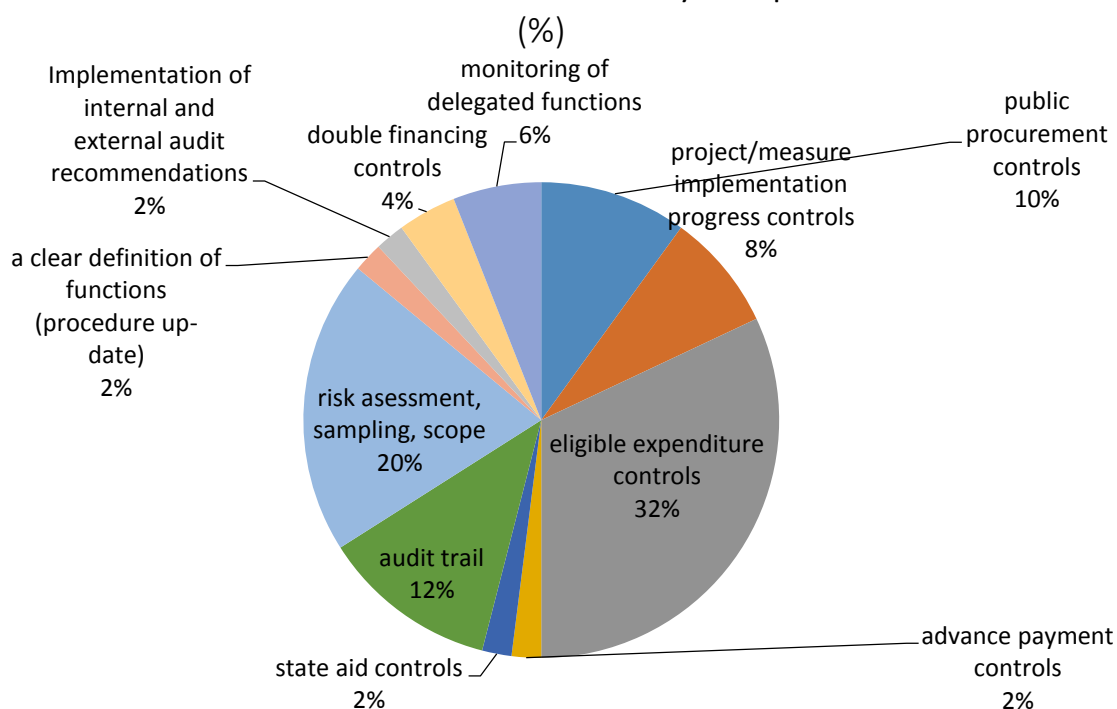
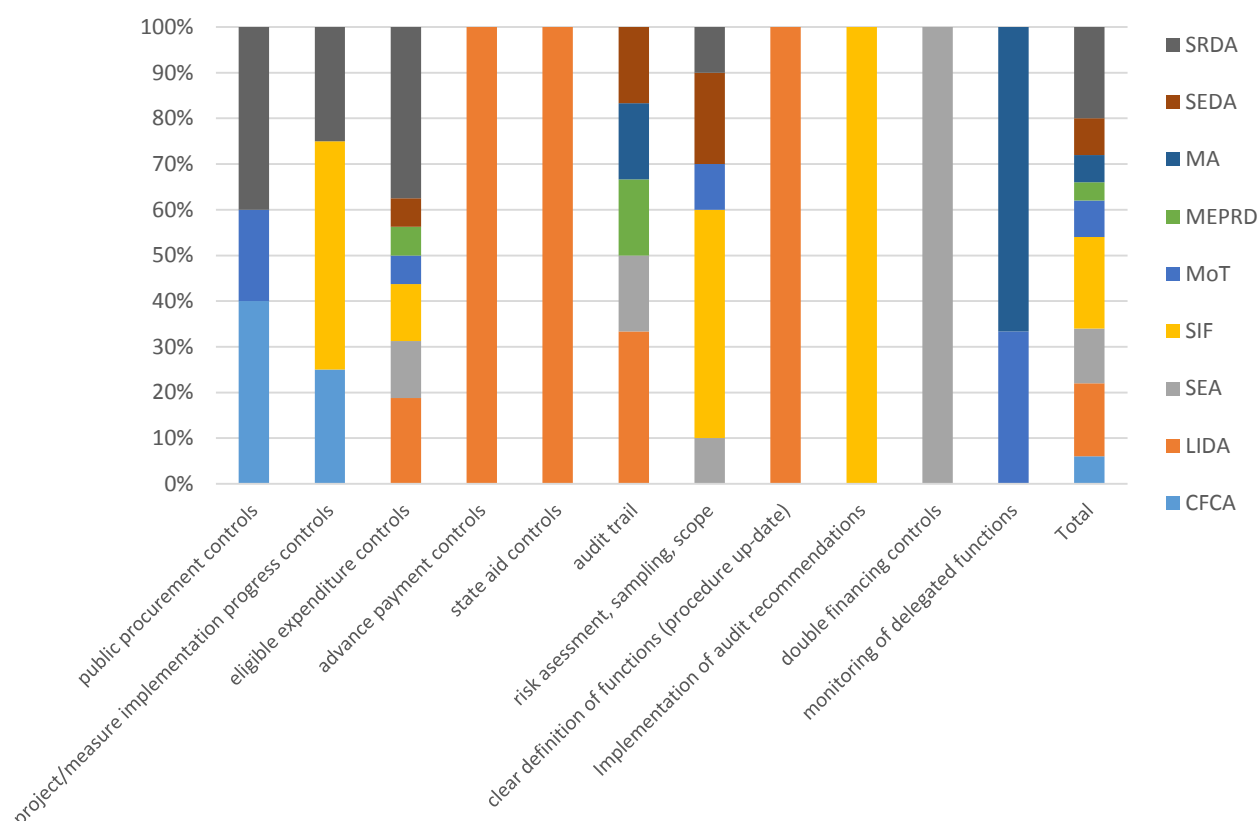


Chart 8

Deficiencies within Key Requirement 4; institutions (%)
(high and average priority)



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 2012 was carried out by the Audit Authority (*See section 1.1*).

Except audit No DR-TP-1/2013 on payment claim of the project No VSID/TP/CFLA/08/10/013 of Technical Assistance, which was performed separately by Audit Body of European Fisheries Fund⁵ to avoid possible conflict of interest as the Audit Authority is the beneficiary of this project.

⁵ Functions Audit Body of European Fisheries Fund in Latvia is performed by Internal Audit department of Rural Support Service

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 26 July 2012.

Audit of operations is performed for expenditure declared to the EC during the period – from 1 January to 31 December 2012 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.

Audit of operations is carried out within the reference period from 1 January to 30 June 2013 for the expenditure declared to EC from 1 January to 31 December 2012 (audit No DR-13/4⁶).

For regular audit one population was formed and one selection was done. Population included certified expenditure of 2012 for all three Operational Programmes.

Sampling unit is a payment claim covering eligible expenditure approved by Certifying Authority and included in statements of expenditure submitted to the EC.

Sampling method was determined according to EC's Guidance note on sampling methods for Audit Authorities (COCOF 08/0021/01-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 2012 population consists of more than 800 sampling units and the sampling method used was statistical sampling – Monetary Unit Sampling (MUS).

For sampling 10 basic selection parameters were used⁷, see *Table 6*.

Table 6: Parameters used for sampling

Parameters	Value
Assurance from the system (SP)	Average
Confidence level	70% ⁸
Book value of expenditure declared (BV)	LVL 580 886 618,37

⁶ Including audit No DR-TP-1/2013 on payment claim No 13 of the Project No VSID/TP/CFLA/08/10/013 of Technical Assistance, which was performed separately by Audit Body of European Fisheries Fund to avoid possible conflict of interest as the Audit Authority is the beneficiary of this project.

⁷ All parameters determined according to European Commission Guidance note on sampling methods for Audit Authorities (COCOF 08/0021/01-EN)

⁸ In accordance with the Annual Control Report approved on 21 December 2012 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%.

Parameters	Value
Materiality level	2%
Tolerable misstatement (TM)	LVL 11 617 732,37
Reliability factor (RF)	1,21
Anticipated misstatement (AM)	15%
Expansion factor (EF)	1,2
Interval	LVL 7 829 968,12
Sample size	5 314 units

From total 5 314⁹ payment claims regarding expenditure declared to EC in year 2012, 76¹⁰ payment claims were selected, see *Table 7*.

Table 7: Expenditure declared during year 2012 and selected units

Population size		Selected sample			Exact verified expenditure		
units	LVL	units	LVL	%	units	LVL	%
Expenditure declared during year 2012							
5 314	580 886 618,37	76	80 141 919,75	13,80	76	75 271 699,15	12,96

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 (LVL)	Sample (units)	Audited expenditure (LVL)	Irregular expenditure found within sample	Error within sample
Expenditure declared during year 2012	580 886 618,37	76	75 271 699,15	438 796,39	0,58%
1 OP (ESF)	86 338 540,18	12	5 452 863,18	234,43	0,00%
2 OP (ERDF)	93 844 038,92	9	15 061 248,57	18,89	0,00%
3 OP (CF and ERDF)	400 704 039,27	53	54 757 587,40	438 543,07	0,80%
1 OP, 2 OP, 3 OP (technical assistance projects) ¹¹	-	2	-	-	-

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.

For the population of the year 2012 MUS was used according to the EC's guidelines¹². Conclusions were reached in several steps according to internal procedures of Audit Authority.

⁹ Total number of payment claims that formed declarations to EC was 6 293. Number of payment claims that formed population used for sampling was 5 314 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)

¹⁰ Calculated sample size was 74 items, but ACL selected 76 items as in the ACL program wasn't transported reconciling items, what increased the number of items

¹¹ The co-financing from OP's – amounts divided between operational programmes

Most likely error for the expenditure declared within 2012 is set as 1,49%, 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 most likely error. All errors were projected to the population¹³. To avoid possibility of statistical interpretation of data Upper error limit was calculated with 2 methods - MUS conservative and MUS standard approach and set as 3,22% (conservative approach) and 2,09% (standard approach). Further actions taken by the Audit Authority regarding results of regular audits of operations are described in *Section 8.1.1*.

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 most likely error for expenditure declared to the EC in year 2012 is 1,49%, 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	1 OP, 2OP, 3 OP ¹⁴	
<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>		<i>5</i>
Systemic errors					
Procurement	-	-	19	-	19
Achievement of the objective of the project	-	-	1	-	1
Eligibility of expenditure	-	2	-	-	2
Supervision of project implementation	-	-	1	-	1
Random errors					
Procurement	-	-	10	1	11
Eligibility of expenditure	3	-	6	-	9
Supervision of project implementation	1	3	19	-	23
Publicity	-	-	2	-	2
Total	4	5	58	1	68

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*.

¹² 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)

¹³ Section 2.6 of the European Commission Guidance on treatment of errors disclosed in the Annual Control Reports (COCOF_11-0041-01-EN)

¹⁴ Technical assistance projects - the co-financing from OP's

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 2012 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 40 recommendations. Implementation status of issued recommendations at the moment of preparation of current ACR:

- 1 – recommendation implemented,
- 39 – deadline of implementation of recommendations is not in force yet.

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

There were no changes in determined and reported error rates regarding ACR 2012.

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

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

1. Procurement – 19 non-compliances detected, all of them are with financial impact. Non-compliances identified regarding:
 - additional works,
 - significant changes to the procurement agreement,
 - discriminatory requirements for applicants.
2. Achievement of the objective of the project – 1 non-compliance detected with financial impact. Liquidated school due to education reforms, which has benefited within Activity No 3.1.3.3.2 “Improvement of Infrastructure in General Educational Establishments for the Students with Functional Disabilities and other Disorders”.
3. Eligibility of expenditure - 2 non-compliances detected without immediate financial impact on declared expenditure. Project revenues from the advances in deposits that can rise financial impact on further declared expenditure.
4. Supervision of project implementation – 1 non-compliance without financial impact detected. Long period of evaluation of information submitted by final beneficiary to Ministry of Transport.

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 (LVL)	Total ineligible expenditure outside the sample	
	Number of errors	Ineligible expenditure (LVL)	Number of errors	Ineligible expenditure (LVL)	Number of errors	Ineligible expenditure (LVL)		In year 2012 (LVL)	Other (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>	<i>10</i>
Procurement	-	-	-	-	19	298 668,06	298 668,06	210 850,22	411 406,26
Achievement of the objective of the project	-	-	-	-	1	32 114,50	32 114,50	0,00	63 301,23
Eligibility of expenditure	-	-	2	0,00	-	-	0,00	0,00	0,00
Supervision of project implementation	-	-	-	-	1	0,00	0,00	0,00	0,00
Total	-	-	2	0,00	21	330 782,56	330 782,56	210 850,22	474 707,49

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

1. Procurement: to eliminate deficiencies in procurement procedures found on the individual project level, recommendations were issued (see Annex 7). Comparing the results from previous year the Audit Authority concluded that the number of deficiencies is at the same level, but amount of ineligible expenditure within the deficiencies is significantly less.

As it was reported in ACR 2012, amendments to Public Procurement Law regarding significant contract amendments came into force in year 2012. As well additional controls (ex-ante checks) for new procurement procedures are in place since January 2012.

Deficiencies in procurement procedures found within regular audit of operations are regarding procurement procedures from 2008 till 2011, when above mentioned actions were not yet implemented.

The Audit Authority will continue follow-up the trend in future reference periods, to ensure that systemic errors within procurement is continuing to decrease and improved procurement control system is working appropriately.

2. Achievement of the objective of the project: impact on control system will be evaluated in management and control system audit No SIST-VIAA-13/24 at the intermediate body responsible for project administration level. Additional management verifications are performed by the Managing Authority.
3. Eligibility of expenditure: taking into account possible interpretation of requirements set up in EU regulations regarding revenues from interest rates by depositing received advance payment the Audit Authority started communication with the Managing Authority. On 19 April 2013 the Managing Authority sent a letter to EC DG REGIO

(No 11-2-07/2366) with request of opinion from the EC on revenues generated within EU co-financed projects. In July the Managing Authority received information from the EC that it is up to the national authorities to decide how to treat interest income. The Audit Authority issued 2 recommendations regarding follow-up of this issue.

4. Supervision of project: It was concluded by the Audit Authority that long evaluation of information and payment claims received from final beneficiaries were identified and covered in management and control system audits in the Ministry of Transport. Last system audit results highlighted that improvements in system was made, situation detected in audit of operations is regarding payment claims evaluated during the previous years (not in 2013).

Regarding additional selection, public procurement was one of the main points of the audit scope of management and control system audits as well as complementary sample was made (see *Section 8.1.1*).

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 purposes and the Opinion of the Audit Authority 2013 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 implementation of recommendations of previous years' system audits it is concluded that institutions that are involved in the management of the EU funds implement the system audit recommendations in accordance with the action plan. However, there are 2 recommendations regarding improvements of the existing system that are not entirely implemented. Regarding implementation of recommendations of financial engineering instruments system audit *see Section 8.2*.

Regarding implementation of recommendations of audits of operations – there were 38 open recommendations reported in the previous ACR (*see Annex 8*). At the moment of preparation of current ACR, there is still 1 recommendation partly implemented and 2 recommendations that are not due until 31 December 2013.

The implementation of the audit No 1DP/2DP/3DP-LIAA-12/3 recommendations to improve LIDA's management and control system of measure

2.3.2.1.0 “Business incubators” was not as timely as stated in the action plan of the audit, due to the time consuming internal consultations and communication with the EC.

Recommendations that are not entirely implemented are related to supervision of deficiencies found by the Audit Authority and updates of procedures of Certifying Authority and 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 2013 performed one complementary audit of operations No PDR-13/18. As it is stated in the *Section 5.3 Most Likely Error* from regular audit of operations is lower than 2% (1,49%) but Upper Limit of Error is larger than 2% (2,09 % and 3,22% depending on MUS approach applied); the Audit Authority concluded that additional work is needed.

Audit No PDR-13/18 has been performed from 9 August 2013 to 21 October 2013 to 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 as advance payments are eligible as well as timely reporting is done on the actual use of advance.

The scope of complementary audit was:

1. 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 and projects in certain sub-measures.

Three populations were determined from the expenditure certified and declared to the EC during the period from 1 January to 31 December 2012¹⁵. The selection was done using the random sampling method (selection done using ACL):

- 1.1. First population was made out of payment claims declared by municipalities due to high number of material errors found in regular audit (55% of total payment claims with errors are within projects where final beneficiaries are municipalities). It was decided to select three projects (five payment claims);
- 1.2. Second population was made out of payment claims declared within Activity 3.1.5.1.1. „Developemnt of Primary Health Care Physician Network”. It was decided to select three projects (five payment claims) due to significant deficiencies found within management and control system audit No SIST-CFLA-13/2;
- 1.3. Third population was made out of payment claims declared within Activity 3.1.5.3.1 „Development of Stationary Health Care”. It was decided to select three projects (five payment claims) due to proportion

¹⁵ Payment claims already audited during regular audits of operations were excluded

of material errors found in regular audit (from two selected payment claims both with errors) and significant deficiencies found within management and control system audit No SIST-CFLA-13/2.

2. Follow-up of advance payments:

Since year 2010 there are seven advance payments declared to the EC (during years 2010, 2011 and 2012) selected by the Audit Authority during regular audits of operations. The Audit Authority followed-up absorption of those advances each year. Four payment claims (declared to the EC during years 2010 and 2011) were audited within the complementary audit of operations No PDR-13/18. One advance payment declared to the EC in 2011 and two advance payments declared to the EC in 2012 were not acquired at the time of complementary audit.

3. 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) as to why the projects were considered as high risk projects.

21 projects were audited – for eight projects full scope audit was done (37 payment claims) and for 13 projects only risky areas covered¹⁶ – 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 from 2010 till the end of 2012.

As the result of complementary audit errors in the fields of public procurement, eligibility of expenditure, supervision of project implementation and achievement of the objective of the project were identified. It was concluded, that advance payments audited are without material errors.

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

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

¹⁶ 21 project were selected - for 9 projects full scope audit was done (38 payment claims) and for 12 projects only risky areas were audited. During the audit (taking into account the actual project implementation) it was decided for one project (one payment claim) not to make full scope audit but cover only identified risky area.

Table 11: Results of complementary audit

Field of error	1 OP		2 OP		3 OP		1 OP, 2 OP, 3 OP		Total ineligible expenditure	
	Number of errors	Ineligible expenditure in 2012 (LVL)	Number of errors	Ineligible expenditure in 2012 (LVL)	Number of errors	Ineligible expenditure in 2012 (LVL)	Number of errors	Ineligible expenditure in 2012 (LVL)	In year 2012 (LVL)	Other (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>	<i>10</i>	<i>11</i>
Procurement	-	-	-	-	19	245 580,36	-	-	245 580,36	215 562,49
Eligibility of expenditure	1	188,77	-	278,12	10	18 335,09	1 ¹⁷	-	18 801,98	46 746,24
Supervision of project implementation	1	0,00	-	-	12	0,00	5	-	0,00	0,00
Achievement of the objective of the project	1	0,00	-	-	-	-	-	-	0,00	0,00
Total:	3	188,77	-	278,12	41	263 915,45	6	-	264 382,34	262 308,73

Accordingly, as a result of the complementary audit of operations 28 recommendations were issued (detailed summary in *Annex 9*)¹⁸. Deadline of implementation of recommendations is not in force yet at the moment of preparation of current ACR.

8.2. Financial engineering instruments audit

In order to implement one of the EC's recommendations formulated in the EC fact-finding mission (No 2007LV161PO001) that took place in Latvia from 18 to 19 January 2010, the Audit Authority performed 2 audits in June and July 2011. The audits were performed in SIA "Latvian Guarantee Agency" (No 2DP/EM/LGA-11/33) and State joint stock company "Latvian Mortgage and Land Bank" (No 2DP/EM/LGA-11/35), where during the fact-finding mission EC auditors found a non-compliance of issued guarantees and loans with Article 45 of EC Regulation No 1828/2006 (guarantees and loans issued within the framework of ERDF financed OP "Entrepreneurship and Innovations" activity 2.2.1.3 "Guarantees for development of enterprise competitiveness" and activity 2.2.1.4 "Loans for development of enterprise competitiveness").

8.2.1. 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, in total 4 letters were sent to DG REGIO (on 3 August, 28 August, 29 October and 5 November 2012). 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

¹⁷ The co-financing from OP's – amounts divided between operational programmes

¹⁸ Results of one audited project is not included because results is under contradictory procedure at the moment of preparation of current ACR

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).

Later in response to the DG REGIO letter No Ares (2013)2385900 of 20.06.2013 one more financial correction was applied by the State Treasury (6 guarantees mentioned in the final position letter of the EC) for the amount of 680 476,89 EUR.

8.2.2. DG EMPL Audit of FEI

DG EMPL mission regarding FEI (No Ares (2012)813285) in the Managing Authority was held from 5 to 8 December 2011. The Final Report in national language was received by Latvian authorities on 9 October 2013. According to the information provided in the report 3 issues were still open: 2 of high and 1 of medium priority. The Managing Authority reported on elimination of these 3 deficiencies on 2 December 2013 (letter No 11-2-07/7591) by sending the updated action plan and supporting documents.

8.2.3. Audit Authority's Audit of FEI

From 2 January to 9 November 2012 the Audit Authority performed horizontal system audit "Financial Engineering Instruments" (No 1DP/2DP-EM/LIAA-11/54) that covered all institutions involved in FEI administration – Managing 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 31 December 2011. The Audit Authority covered all 7 key requirements and took into account Common Audit Framework for Financial Engineering Instruments in the context of structural funds (DG REGIO 31 July 2011) and integrated 3-phased approach into a standard approach.

Audit results – audit report for the EC was uploaded to SFC2007 on 11 December 2012. For elimination of deficiencies the Audit Authority issued 19 recommendations and 5 of them were of high priority.

On 15 October 2013 the Audit Authority started a new horizontal system audit on FEI activities; implementation of recommendations of the audit No 1DP/2DP-EM/LIAA-11/54 will be checked within the scope of this audit.

The Audit Authority does not provide a common assessment of management and control system of FEI due to fact that there are still open issues that are not closed by DG EMPL.

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

The Audit Authority has collected the information on the recommendations of the EC audits that are due as on 30 November 2013 and concluded that the institutions involved in the management of the EU funds implement recommendations in accordance with the action plan.

The DG REGIO audit mission No 2012/LV/REGIO/J2/1160/1 (22 to 26 October 2012) was carried out 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). Before issuing the final report, Certifying Authority had already implemented remedial actions to improve the administration of irregularities. Final report was received on 12 November 2013 and all findings are closed.

The DG REGIO audit mission No 2012/LVIREGIO/J2/1158/1 (22 to 26 October 2012) was carried out 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 (as pointed out in DG REGIO letter of 27 January 2012 ARES (2012) 94198). The action plan addressed deficiencies in the Managing and Certifying Authority identified in respect of three key requirements (Managing Authority - Key requirement 1, Key requirement 4, Key requirement 10; Certifying authority - Key requirement 10). On 6 December 2013 EC Final Position letter was received stating that no deficiencies were found and the audit is therefore closed.

Closure letter of the three DG REGIO missions (No 2011/LV/REGIQ/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.

Regarding EC audits on FEI *see Section 8.2.*

Audit Authority's work has been assessed by the EC also during the reference period. 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 is not received yet.

In July 2013 European Court of Auditors' mission within Statement of Assurance 2013 was carried out in order to assess regularity and legality of ESF (“Human Resources and Employment (No 2007LV051PO001) (1 OP)” expenditure. Report is not received yet.

8.4. 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.

8.5. Assessment of the Audit Authority

In the period from 1 January to 30 November 2013 the Audit Authority's work has been assessed only by the EC. 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 is not received yet. *See section 8.3.*

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