



Interreg
Estonia-Latvia
European Regional Development Fund



Interreg V-A – Estonia-Latvia

Audit of Financial Control function

Audit No JKS-14/2018

Final Report

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REPUBLIC OF ESTONIA
MINISTRY OF FINANCE

Audit final report recipients:

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EXECUTIVE SUMMARY

The purpose of this audit was to assess the effectiveness of the management and control systems (herewith as MCS) of Cooperation Programme Interreg V-A – Estonia-Latvia (herewith as Programme) in administrating the Financial Control function of the Programme (herewith as FC).

The assessment was carried out on the basis of the key requirements 1, 4, 5 and 7 (herewith as KR1-KR7, respectively) as defined with the Commission Delegated Regulation (EU) No 480/2014 and specified with the EC Guidance for the Commission and Member States on a common methodology for the assessment of management and control systems in the Member States (EGESIF_14-0010 18/12/2014).

By compiling the final audit opinion, the auditors took into account the evidence gathered and conclusions made during the audit work.

SUMMARY OF THE AUDIT RESULTS

As the result of this audit, the Audit Authority (herewith as AA) is in opinion that the MCS of the Programme in respect of the KR1, KR4, KR5 and KR7 **works, but some improvements are needed** (Category 2¹).

For the FC in Latvia, the opinion of the MCS is better than for the Programme as a whole: **works well, only minor improvements needed** (Category 1).

For the FC in Estonia, due to the fact that the Finding 1.2 (see details below) affects only the FC in Estonia, the AA is in opinion that the MCS **works, but some improvements are needed** (Category 2).

The detailed results by assessment criteria of the KR1, KR 4, KR5 and KR7 are presented in Part B of this report and the summary table of results in Annex 1.

During the audit, the following **significant**² findings were made:

[Finding No 1.2 - There is a lack of staff and experience in the Estonian side of the FC and the four-eye principle is not followed \(significant\)](#)

[Finding No 1.6 - The FC should be included by the MA in its risk assessment and management exercise as soon as possible \(significant\)](#)

[Finding No 4.3 - The checklist on which management verifications are based on should be updated and the practice of its use should be harmonized \(significant\)](#)

¹ Category 1 – Works well. No or only minor improvements needed

Category 2 - Works, but some improvements are needed

Category 3 – Works partially; substantial improvements are needed

Category 4 – Essentially does not work.

² **Significant findings** are findings that describe an error in the auditee's MCS which has a significant effect on the possibility of fulfilling its critical tasks and requirements (this may include systemic errors). Significant findings require immediate action from the auditee's management in order to correct those errors.

Non-significant findings are findings that describe an error in the auditee's MCS which has a non-significant effect on the possibility of fulfilling its critical tasks and requirements (this may include random errors). Non-significant findings require action from the auditee's management in order to correct those errors.

[Finding No 4.4 - Evidence should be kept in the eMS system of all administrative verifications, on-the-spot verifications and on the follow-up of findings detected \(significant\)](#)

The auditors make the assumption that the information presented to them during the audit including both in written and verbal form describe the MCS of the Programme correctly and in accordance with its actuality. Should there exist information that was not known or not presented to the auditors at the time, the results and the opinion may have been different.

The audit has been carried out in accordance with internationally accepted internal auditing standards of the IIA – International Standards for the Professional Practice of Internal Auditing.

The final audit report will be published at the homepage of the Ministry of Finance.

The audit team wishes to thank the employees of the Programme for their cooperation and assistance during the audit work.

Final Report consists of 14 pages.

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(Signed electronically)

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	2
TABLE OF CONTENTS	4
PART A	5
1. SUMMARY OF THE AUDIT WORK	5
2. SAMPLING METHODOLOGY	5
3. BACKGROUND INFORMATION.....	6
4. FOLLOW-UP AND MONITORING	6
PART B	7
FINDINGS AND RECOMMENDATIONS	7
<i>Finding No 1.1 - The description of the FC organization needs to be updated in the DMCS and on the programme webpage (non-significant).....</i>	<i>7</i>
<i>Finding No 1.2 - There is a lack of staff and experience in the Estonian side of the FC and the four-eye principle is not followed (significant).....</i>	<i>7</i>
<i>Finding No 1.4 - The monitoring of the tasks of the FC by the MA should be enhanced (non-significant).....</i>	<i>9</i>
<i>Finding No 1.6 - The FC should be included by the MA in its risk assessment and management exercise as soon as possible (significant).....</i>	<i>9</i>
<i>Finding No 4.3 - The checklist on which management verifications are based on should be updated and the practice of its use should be harmonized (significant).....</i>	<i>10</i>
<i>Finding No 4.4 - Evidence should be kept in the eMS system of all administrative verifications, on-the-spot verifications and on the follow-up of findings detected (significant).....</i>	<i>11</i>
<i>Finding No 7.3 - There should be additional training organized to the FC-s focused on the anti-fraud measures (non-significant).....</i>	<i>12</i>
ANNEX 1 – SUMMARY OPINION OF THE AUDITEE’S MCS	14

PART A

1. Summary of the audit work

In accordance with the Article 127(1) of the CPR and the working plan of the AA for the year 2018, the AA carried out an audit on the MCS on the FC of the Programme as used for the programming period of 2014-2020 both in Estonia and Latvia. The purpose of the audit was to give an independent opinion on the functioning and effectiveness of the MCS in that regard.

The audit was carried out between 28th of February 2018 and 3rd of August 2018. The audit was managed and the audit procedures carried out by a Lead Auditor of Audit Unit II of the Financial Control Department of the Ministry of Finance of Estonia (herewith as FCD), Mart Pechter. The audit team consisted of also an Auditor of Audit Unit II of the FCD, Hannes Vahemäe and an Auditor from the Internal Audit Department of the Ministry of Environmental Protection and Regional Development of Latvia, Dace Zvirgzdiņa. The audit supervisor was the Head of Audit Unit II of the FCD, Kadi Peets.

In order to present an opinion, the MCS in regards to the FC function was analyzed and tested in accordance with the KR1, KR4, KR5 and KR7.

The audit was based on the following documents:

- Programme Manual of the Programme (updated August 2017);
- Description of the MCS of the Programme (updated on the 15th of November, 2016);
- Methodologies and specific documents related to those documents used by the FC-s, such as the methodology of sampling, national methodologies of on-the-spot checks and national checklists of public procurement;
- Selected reports, checklists and certificates of the FC related to those reports and any information related to those reports available in the eMS system or from the FC-s.

In order to form an opinion, the following audit procedures were carried out:

- The evaluation of compliance of the principles of the FC set out in the description of the MCS;
- Testing in the practice of the Programme in comparison with the principles of the KR1, KR4, KR5 and KR7 by selecting a number of projects, partners and reports and observing the principles of the FC as they were actually used;
- Conducting interviews with the key officials of the Programme in the FC function both in Estonia and Latvia, the MA, the JS and the NRA-s.

The audit work was based on the methodology developed by the FCD for the programming period of 2014-2020.

2. Sampling methodology

In order to test for the practice, different projects and reports from those were selected for testing as follows:

- Two unique projects and four unique reports (two for Estonia and two for Latvia) for general testing, where all aspects of the reports were considered;
- Two unique projects and four unique reports (two for Estonia and two for Latvia) for testing for how the project activities had been fulfilled;
- Two unique projects and four unique reports (two for Estonia and two for Latvia) for testing for findings made by the FC-s and their processing;
- One unique project and report (for Estonia) for testing for sampling used by the FC-s;

- Two unique projects and two unique reports (one for Estonia and one for Latvia) for testing for public procurement and how it was handled by the FC-s.

In total, nine unique projects (five for Estonia and four for Latvia) and 15 unique partner reports (eight for Estonia and seven for Latvia) were tested in different ways.

The tables and other information compiled by the eMS were viewed without singling out specific projects.

3. Background information

In accordance with the Article 127(1) of the CPR, the AA shall ensure that audits are carried out on the proper functioning of the MCS of the operational programme.

For the Programme in the 2014-2020 programming period, the previous relevant audit of the MCS has been a Compliance audit of the MA (No III-2/2016) from 14th of December 2016 with an **unqualified opinion** on the description of the MCS.

The audit was added to the working plan of the AA, because it was deemed a critical function of the Programme that had not been audited yet.

4. Follow-up and monitoring

The auditee must take into consideration all the findings and recommendations presented in the Part B of this report. The MA is responsible for the follow-up and monitoring of the implementation of measures taken as a result and will report of the results in a written form. The final opinion on the implementation of measures will be given by the AA. If necessary, a follow-up audit may be conducted.

PART B

FINDINGS AND RECOMMENDATIONS³

Key requirement 1: Adequate separation of functions and adequate systems for reporting and monitoring where the responsible authority entrusts execution of tasks to another body

As the result of this audit, the auditor finds that the MCS of the Programme of the FC function regarded via the KR1 works, but some improvements are needed (Category 2)⁴

Finding No 1.1 - The description of the FC organization needs to be updated in the DMCS and on the programme webpage (non-significant)

The article 72 (a) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that the Management and control systems shall provide for a description of the functions of each body involved in management and control, and the allocation of functions within each body.

As the auditors assessed the description of functions of the FC, they discovered that the information listing specific people of the FC in Estonia and the FC in Latvia is out of date in both the programme webpage and in the DMCS. In addition to that, the organization chart of the FC in Latvia presented in the DMCS is also out of date.

RISK: Incorrect descriptions may present complications in the workings of the programme

RECOMMENDATION: This information should be updated.

COMMENT FROM THE MA: Information on the programme web-page will be updated in May 2018. As the DMCS will be updated in relation to relocation of programme authorities with the deadline 1 September 2018 (written procedure will be started in June 2018), information about FCs will be updated in the frames of that procedure. The FCs will inform the MA, if there are any changes.

COMMENT FROM THE ESTONIAN FC: We agree. Information should be updated and we will inform if there will be any changes.

COMMENT FROM THE LATVIAN FC: We agree that information should be updated. Latvian FC regularly informed MA and JS about the changes in FC staff with the Questionnaire.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and consider this finding closed.

Finding No 1.2 - There is a lack of staff and experience in the Estonian side of the FC and the four-eye principle is not followed (significant)

The article 72 (h) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that the Management and control systems shall provide for the prevention, detection and correction of irregularities.

As the auditors assessed the functions of the FC, they discovered the following:

- On the Latvian side, there are six people on permanent contracts mainly or partly dealing with the costs of the Estonia-Latvia programme. In addition to that, on the unit level their work is first complemented by

³ Audit findings are listed according to the order of assessment criteria of the MCS assessment methodology

⁴ Category 1 – Works well. No or only minor improvements needed

Category 2 - Works, but some improvements are needed

Category 3 – Works partially; substantial improvements are needed

Category 4 – Essentially does not work.

procurement experts in the same unit, who are able to consult them on procurement questions. Then the work is supervised by the Head of Unit who performs checks based on the four-eye principle and marks their name on the FC certificate in the eMS system. The FC in Latvia is also recruiting more people to their department.

- On the Estonian side, there are two people on permanent contracts mainly or partly dealing with the costs of the Estonia-Latvia programme. There are no procurement experts in the department to be consulted and the Head of Unit does not perform checks based on the four-eye principle, although their name is marked on the FC certificate in the eMS system. The FC in Estonia is also not recruiting more people to their unit.

The auditors concur that the risks in connection with the lack of expertise on procurement in the FC in Estonia have been mitigated by referring questions to the Public Procurement and State Aid Department in the organization and this area needs no further improvement

The auditors also concur that the risks in connection with the amount of people in the FC in Estonia have been partly mitigated by the usage of temporary contracts under the law of obligations. This employs an additional eight people, who have also been partly dealing with the costs of the Estonia-Latvia programme. Still, it is acknowledged that the people on temporary contracts are less experienced than those on permanent ones and thus this solution has increased the risk from the lack of expertise.

However, the auditors are of an opinion that the risks of forgoing the four-eye principle in Estonia greatly increases the risks inherent in the lack of staff and expertise.

RISK: In the Estonian side of the FC, the lack of staff on permanent contracts, the lack of expertise in the staff on temporary contacts and the lack of the four-eye principle in practice endangers the main function of the FC on the prevention, detection and correction of irregularities.

RECOMMENDATION: The auditors strongly recommend the following for the practice of the FC in Estonia:

- Employing more staff or making the arrangement of the temporary contracts permanent in practice. This is recommended to be done as soon as possible.
- Start using the four-eye principle in practice, covering at minimum the eMS checklists and the Estonian public procurement checklists. This is recommended to be done immediately.

COMMENT FROM THE MA: The MA is aware of the risks related to human resources of Estonian FC. Currently Estonian FC uses temporary staff working with authorization agreements, and even though it reduces the heavy workload, there were problems related to the quality of work of the temporary staff, especially in the beginning of the previous contracting of temporary staff in 2017, when the staff had to be acquainted with the eMS and checklists. MA, when carrying out the tasks of the Certifying Authority, checks the quality of FC controls as a precondition of certifying costs, and if necessary, sends the workflow back to the FC (or JS) for improvement. It is possible to say that by now the quality has improved.

MA has supported Estonian FC in finding solutions to the problems related to human resources. We hope that after relocation of the programme authorities to the State Shared Service Centre it will be possible to hire additional staff under employment contracts. The Heads of MA and Estonian FC have discussed that when additional staff will be hired in the State Shared Service Centre, workload of the Head of Estonian FC will reduce, and as a result, it enables the Head of Estonian FC to start carrying out four-eye principle.

COMMENT FROM THE ESTONIAN FC: The FC is very aware of the risk of lacking the staff. The heavy workload and the absence of expertise involvement affects the proper and smooth functioning. We can make the four-eye principle usage possible in practice if the recruitment of more labor force is implemented.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and will monitor the practice as it is implemented to ensure that the risk will be mitigated.

Finding No 1.4 - The monitoring of the tasks of the FC by the MA should be enhanced (non-significant)

The article 72 (h) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that the Management and control systems shall provide for reporting and monitoring where the body responsible entrusts execution of tasks to another body.

As the auditors assessed the functions of the FC, they discovered the following:

- The FC in Estonia and the FC in Latvia have coordination meetings organized by the JS, which have taken place around once a year so far. This frequency of coordination meetings is less than other comparable ETC programmes have
- The FC in Estonia also takes a part of the programme bodies' meeting held by the MA, which have taken place once every one or two months so far. The FC in Latvia does not currently have this option.

RISK: Insufficient communication between the programme bodies may contribute to an uneven practice of those bodies.

RECOMMENDATION: The auditors recommend the MA to do the following:

- Increase the number of the coordination meetings to the average of two per year.
- Include the FC in Latvia in the programme bodies' meeting either via a video link or in person.

COMMENT FROM THE MA: The MA has involved Latvian FC (and Latvian NRA) to the monthly meetings of the programme authorities via skype. The first meeting with their presence took place on 8 May 2018. In addition, we discussed the possibility to meet in person once a quarter during the monthly meeting on 8 May 2018, but at the moment skype meetings were found suitable. Still, if necessary, the meetings in person will be organized. As regards the number of coordination meetings per year, topics related to FC will be discussed during monthly meetings of the programme authorities, but if necessary, the MA with the help of JS will organize the second annual meeting.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and consider this finding closed.

Finding No 1.6 - The FC should be included by the MA in its risk assessment and management exercise as soon as possible (significant)

The annex XIII point 2 of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that the MA is responsible for a framework for ensuring that an appropriate risk management exercise is conducted when necessary. This should also include fraud risk assessment.

As the auditors assessed the functions of the FC, they discovered that at the time of the audit, the MA had not yet included the FC in its risk assessment and management exercise for the programme either by external assessment or by asking the FC in Estonia and Latvia to conduct self-assessment and report the results.

RISK: Not conducting the risk assessment and management exercise for all programme bodies may leave the MA with an incomplete or distorted picture of the functioning of the programme.

RECOMMENDATION: The auditors recommend the MA to include the FC in their risk assessment and management exercise for this year and ensure that the fraud risk assessment is also included in it.

COMMENT FROM THE MA: The MA has included the FCs of both Estonia and Latvia to the risk assessment exercise in 2018 and this practice will continue in the coming years. Both FCs (and Latvian NRA) have sent their input to identify risks and define risk management activities. Estonian FC participates during the risk assessment meeting in Tartu on 28 May 2018, and both FCs (and NRAs) will be involved in the finalization and implementation of the risk management action plan.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and will monitor the practice as it is implemented to ensure that the risk will be mitigated.

Key requirement 4: Adequate management verifications

As the result of this audit, the auditor finds that the MCS of the Programme of the FC function regarded via the KR4 works, but some improvements are needed (Category 2)⁵

Finding No 4.3 - The checklist on which management verifications are based on should be updated and the practice of its use should be harmonized (significant)

The article 125 point 5(a) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that the verifications include administrative verifications in respect of each application for reimbursement by beneficiaries.

As the auditors assessed the functions of the FC, they discovered the following:

- There are a few additions and deductions that could be done in regards to the FC checklist in the eMS system.
- The practice of using the checklists in general should be harmonized between the FC in Estonia, the FC in Latvia and within the practice of both FC-s as well.

For the first point, the topic of correctness of the financing rate should be added to the checklist. Additionally, since the procurement checks are already based on the national checklists, the section pertaining to procurement could be significantly shortened.

For the second point, there are a number of areas of practice in filling out the checklists that are in need of harmonization. At least the following points should be clearly set in practice:

- All boxes should always be ticked and all questions answered.
- Any comments in the system should only be in English.
 - The exceptions here are the national checklists of public procurement and on-the-spot checks as well as the communication files with the beneficiaries.
- Any comments should be added whenever it is possible with the intention that the next reader of the checklist should be able to easily understand all decisions made by the controllers.
- Any comments are of a critical importance whenever costs are deducted and should be as detailed as possible in those cases.

Although the national checklists of public procurement and on-the-spot checks are mentioned as exceptions, this concerns only the practice of adding comments in English. The other points of harmonization presented here should extend to their use in a similar way.

RISK: Not incorporating the additions and deductions to the FC checklist in the eMS system may result in a lower level of assurance in administrative verifications, as not all necessary points are covered but excessive information is added under one specific point. Not harmonizing the practice of filling out the checklists may result in the inconsistency of information available in the eMS system, hindering the work of other programme bodies reliant on that information.

RECOMMENDATION: The auditors recommend updating the FC checklist in the eMS system. The auditors also recommend setting out clear harmonization principles to the use of the FC checklist and the other checklists as well, based on the points that the auditors have mentioned. Those principles should then be either set in writing or clearly communicated to the controllers via training.

COMMENT FROM THE MA: The MA agrees with the auditors that all the necessary information has to be in the eMS, but only once; it is necessary to give answers to each question in the check-lists and all the comments have to be in

⁵ Category 1 – Works well. No or only minor improvements needed
Category 2 - Works, but some improvements are needed
Category 3 – Works partially; substantial improvements are needed
Category 4 – Essentially does not work.

English. The MA will initiate the discussions with FCs and eMS manager about the topics – content of check-lists, quality of filling in check-lists, language – in summer 2018, to ensure that by 1 October 2018 the eMS will be updated and there will be mutual understanding between the FCs, MA and JS about the content of check-lists and quality of the data in eMS. After that, a (skype) meeting will be organized in October 2018 to discuss the developments and ensure further accurate use of the updates in eMS and short guidelines will be developed for the FCs.

COMMENT FROM THE ESTONIAN FC: We agree that the comments should be added in any case of the deviation is found. In case of the deduction or any other issue it is possible to describe or comment the content of the deduction or any other issue under the FLC Documents both on the sheet of FLC Checklist and FLC Report (under the relevant question or section). Thus it makes the cause of the deduction or any other issue more visible and easier found.

COMMENT FROM THE LATVIAN FC: We agree that the procurement checklists in eMS could be shortened because the national checklists will be added. We recommend do not add communication files for all reports. Usually the communication between the FC and PP is 5 emails and more and the requirement to add them all to the system will significantly increase the administrative burden. FC could send them by email, if communication files will be necessary for other authorities.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and will monitor the practice as it is implemented to ensure that the risk will be mitigated.

Finding No 4.4 - Evidence should be kept in the eMS system of all administrative verifications, on-the-spot verifications and on the follow-up of findings detected (significant)

The article 125 point 4(c) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that there should be put in place effective and proportionate anti-fraud measures.

As the auditors assessed the functions of the FC, they discovered the following:

- Different sources of information are not stored in the eMS system at the moment.
- There is no harmonized policy concerning which additional information files are uploaded, where are they uploaded and how are they cross-referenced with comments.

For the first point, the auditors have identified a number of files generated in the management verifications process that are not available in the eMS system, but should be in the interest of making the process understandable and verifiable. They are as follows:

- The national procurement checklists.
- The national checklists of on-the-spot verifications.
- The correspondence between the FC and the partner that explains the results of any questions and answers during the FC checks (either as an e-mail conversation or specific working paper).
- The information on any recommendations made by the FC as a result of their findings (either as an e-mail conversation or specific working paper).

For the second point, there are a number of areas of practice in adding the information files and references that are in need of harmonization. At least the following points should be clearly set in practice concerning additional uploaded information files and cross-referencing:

- If additional information is required from the partner, those information files should always be uploaded into only one specific section of the eMS system.
- Whenever new information files are added to the system, they should be cross-referenced with the cost documents or the questions and comments on the checklist that they are connected with

The points of harmonization presented here should extend to the use of the national procurement checklists and on-the-spot checks in a similar way.

RISK: Not adding information that is critical to understanding the management verifications process to the eMS system and not harmonizing the practice of adding the information files and references may result in the

inconsistency of information available in the eMS system, hindering the work of other programme bodies reliant on that information.

RECOMMENDATION: The auditors recommend updating the policy of which information files should be uploaded in the eMS system. The auditors also recommend setting out clear harmonization principles to the practice of adding the information files and references, based on the points that the auditors have mentioned. Those principles should then be either set in writing or clearly communicated to the controllers via training:

COMMENT FROM THE MA: Manager of the eMS has confirmed that it is possible to upload relevant documents to the eMS system, but as a common understanding about the documentation to be uploaded to eMS is needed on programme level, the MA will initiate the discussions with FCs and eMS manager in June 2018, to ensure that by 1 October 2018 there will be mutual understanding between the FCs, MA and JS about which documents must be uploaded to eMS. In October 2018 short guidelines will be developed for the FCs.

COMMENT FROM THE ESTONIAN FC: We can upload the relevant documents to eMS system under the section of FLC Documents under the sheet of Attachments. It should be added here that we probably won't be able to reference all the new information files with the connected documents because there is limited options available (only in checklist under the relevant question). Otherwise all the new information files can be uploaded to eMS system and found there mostly with the characterizing filename.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and will monitor the practice as it is implemented to ensure that the risk will be mitigated.

Key requirement 5: Effective system in place to ensure that all documents regarding expenditure and audits are held to ensure an adequate audit trail

As the result of this audit, the auditor finds that the MCS of the Programme of the FC function regarded via the KR5 works but some improvements are needed (Category 2)⁶

The auditors made no findings in regards to the KR5, but they find that the significant finding 4.4 has also an effect to the KR5, which makes the opinion on this key requirement Category 2.

Key requirement 7: Effective implementation of proportionate anti-fraud measures

As the result of this audit, the auditor finds that the MCS of the Programme of the FC function regarded via the KR7 works, but some improvements are needed (Category 2)

The auditors made one non-significant finding in regards to the KR7, but they find that the significant finding 1.6 has also an effect to the KR7, which makes the opinion on this key requirement Category 2.

Finding No 7.3 - There should be additional training organized to the FC-s focused on the anti-fraud measures (non-significant)

The article 72 (g) of the Regulation (EU) No 1303/2013 of the European Parliament and of the Council states that the Management and control systems shall provide for procedures to ensure an adequate audit trail.

⁶ Category 1 – Works well. No or only minor improvements needed
Category 2 - Works, but some improvements are needed
Category 3 – Works partially; substantial improvements are needed
Category 4 – Essentially does not work.

As the auditors assessed the functions of the FC, they discovered that although the information related to the anti-fraud measures is adequately stated in the DMCS, the FC-s in Estonia and Latvia were both independently of the opinion, that additional training in anti-fraud measures would be helpful.

RISK: Not complementing the principles with additional training may leave the staff unsure about the actual purpose of the principles and their connection with their day-to-day practice.

RECOMMENDATION: The auditors recommend organizing additional training to the staff of the FC-s, focusing on the anti-fraud measures.

COMMENT FROM THE MA: The MA will look for a solution to train the staff of the FCs about anti-fraud measures, and encourages the staff of FCs to participate in external (for example Interact) trainings.

ADDITIONAL COMMENT FROM THE AA: We agree with the proposed actions and consider this finding closed.

ANNEX 1 – Summary opinion of the auditee’s MCS

Key requirement	Category 1	Category 2	Category 3	Category 4
Key requirement 1: Adequate separation of functions and adequate systems for reporting and monitoring where the responsible authority entrusts execution of tasks to another body		X		
Key requirement 4: Adequate management verifications		X		
Key requirement 5: Effective system in place to ensure that all documents regarding expenditure and audits are held to ensure an adequate audit trail		X		
Key requirement 7: Effective implementation of proportionate anti-fraud measures		X		
Summary opinion of the auditee’s MCS		X		

Member State	Category 1	Category 2	Category 3	Category 4
Estonia		X		
Latvia	X			