
Audit of the Management and Control System of the Certifying Authority of the Norwegian and European Economic Area Financial Mechanisms 2014-2021

Audit No JKS-36/2020

Final Report

16.12.2020



REPUBLIC OF ESTONIA
MINISTRY OF FINANCE

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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 (hereinafter **MCS**) of **the Certifying Authority** (hereinafter **CA**) by implementing the Norwegian and European Economic Area Financial Mechanisms 2014-2021 (hereinafter **FM**).

The assessment was carried out on the basis of the adjusted¹ key requirements 9, 10, 11, 12 as defined with the Commission Delegated Regulation (EU) No 480/2014², Article 5.1 and 5.4 of the **Regulations**¹ and Article 3 of the Detailed Management Control System Description (hereinafter **DMCS**) for the National Focal Point (hereinafter **NFP**), the CA, the Auditing Authority (hereinafter **AA**) and the Irregularities Authority (hereinafter **IA**).

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 **AA** is in opinion that the MCS of the CA of the FM in respect of the adjusted key requirements 9, 10, 11, 12 **works, but some improvements are needed** (Category 2³).

The main findings (significant⁴):

- The management costs of the Programme Operators (hereinafter **PO-s**) have been submitted to the Financial Mechanism Office (hereinafter **FMO**) without carrying out risk-based verification of the supporting documents by the CA. The Rules of Procedure of NFP and CA of the FM 2014-2020/21 (hereinafter **RoP**) did not specify the CA-s procedures on verifying the PO's management costs on the basis

¹ Specified according to the requirements of the following regulations (hereinafter **Regulations**):

a) Regulation in the implementation of the European Economic Area Financial Mechanism for 2014-2021 is adopted by the EEA Financial Mechanism Committee pursuant to Article 10.5 of Protocol 38c to EEA Agreement on 8 September 2016 and confirmed by the Standing Committee of the EFTA States on 23 September 2016.

b) Regulation on the implementation of the Norwegian Financial Mechanism 2014-2021 is adopted by the Norwegian Ministry of Foreign Affairs pursuant to Article 10.5 of the Agreement between the Kingdom of Norway and the European Union on a Norwegian Financial Mechanism for the period 2014-2021 on 23 September 2016

² 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).

³ 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.

⁴ **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.

of supporting cost documents, including the sampling procedures (the RoP have been amended in November 2020).

The detailed results by assessment criteria are presented in Part B of this report and the summary table of results in Annex 1.

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 CA 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 of Estonia.

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

Final Report consists of 18 pages.

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PART A

1. Summary of the audit work

In accordance with Article 5.5 (1)(a) of the Regulations and the working plan of the AA for the year 2020, the AA carried out an MCS audit on the CA of the FM. The purpose of the audit was to give an independent opinion on the functioning and effectiveness of the MCS of the CA in that regard.

The previous relevant audit of the MCS of the CA of the FM was the Compliance audit of the NFP/CA/AA/IA (No II-186/2017) from 13th of September 2017⁵ with an unqualified opinion on the description of the MCS. The current audit of the MCS of the CA of the FM was added to the working plan of the AA, because it was deemed a critical function in implementing the FM.

As the unit carrying out the tasks of the CA of the FM (Norwegian and EEA Certifying Unit of the Grants Payment Department of the SSSC), is located in the same department (Grants Payment Department of the SSSC) which is also responsible for carrying out the tasks of the CA for the European Structural and Investment Funds (hereinafter ESIF) (with the exemption of the final responsible person as the head of the CA) and the procedures of the CA-s are in great extent similar, the AA relies by compiling its opinion also on the results of the MCS audit of the CA of the ESIF. The last audit of the MCS of the CA on the ESIF JKS-36/2020 was finalized by AA on 08.10.2020 with the assessment Category I⁴.

The MCS audit of the CA of the FM was carried out between 31th of March 2020 and 16th of December 2020, including carrying out the audit procedures during the period of 31th March till 20th of May 2020 and 4th of August till the 21th of October 2020. The draft audit report was issued on 3rd of November 2020 and the closure meeting on the audit findings held on 9th of December 2020. During the closure meeting, the auditees and the auditors discussed the risks, as presented in the draft audit report, and their impact on the functioning of the system, which was the basis for compiling the final audit report.

The audit was managed and the audit procedures carried out by the Lead Auditor of Audit Unit II of the Financial Control Department of the Ministry of Finance of Estonia (hereinafter FCD), Liina Vörklaev. The audit supervisor was the Head of Audit Unit II of the FCD, Kadi Peets.

In order to present an opinion, the key requirements 9, 10, 11, 12 of assessing the MCS of the ESIF were adjusted to meet the requirements for the MCS and the tasks of the CA as stipulated with the Articles 5.1 and 5.4 of the Regulations and Article 3 of the DMCS as follows.

Key requirement 9: Adequate **separation of functions** and adequate systems for reporting and monitoring in cases where the responsible authority entrusts execution of tasks to another bod.

Article 5.1 (2) of the Regulations: The MCS-s shall provide for:

(a) the definition of the functions of the entities concerned in management and control and the allocation of functions within each entity; compliance with the principle of separation of functions between and within such entities;

(b) compliance with the principle of separation of functions between and within such entities;

⁵ Adjusted report on 01.10.2019

Key requirement 10: Adequate procedures for drawing up and submitting payment applications
Article 5.1 (2c) of the Regulations: The MCS-s shall provide for procedures for ensuring the correctness and regularity of expenditure;
Article 5.4 (1) of the Regulations: the detailed functions of the CA
Key requirement 11: Appropriate computerized records of expenditure declared and of the corresponding public contribution are maintained;
Article 5.1 (2 d) of the Regulations: The MCS-s shall provide for: reliable accounting, monitoring and financial reporting systems in computerized form;
Article 5.4 (2) of the Regulations: The CA shall ensure the establishment and maintenance of a separate interest-bearing bank account
Key requirement 12: Appropriate and complete account of amounts recoverable, recovered and withdrawn;
Article 5.1 (2 h) of the Regulations: The MCS-s shall provide for reporting and monitoring procedures for irregularities and for the recovery of amounts unduly paid.

Detailed sub-criteria and questions were used to assess compliance with each key requirement.

The audit was based on the following documents:

- Memorandums of the Understanding on the implementation of the Norwegian Financial Mechanism 2014-2021 and European Economic Area Financial Mechanism 2014-2021 from 9th of May 2017 (updated 21.06.2019, hereinafter **MoU-s**);
- Regulations (updated 23.09.2016);
- DMCS of the NFP/CA/AA/IA (updated on the 23.09.2019);
- Decree of the Government of the Republic of the Estonia No 55 from 5th of July 2018 “Conditions and procedure for applying for and using funds from the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism 2014-2021”(hereinafter **Decree of the Government**);
- RoP (updated 01.04.2020);
- Interim Financial Report (hereinafter **IFR**) No 4 of the Technical Assistance (hereinafter **TA**) of the NFP (submitted to FMO by 13.03.2020);
- Checklist of the IFR, filled by the CA;
- Reports available in the Grace information system and Structural Funds Operating System (hereinafter **SFOS**).

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

- The analysis of the tasks of the CA by the ESIF, and by the FM to figure out in which extent the procedures are similar and whether it is appropriate to rely on the results of the audit of the CA of the ESIF conducted in the same time frame by FCD;
- Testing whether all the tasks of the CA stipulated in the Article 5.4 of the Regulations are covered by the written procedures in RoP and activities of the CA;

- The assessment whether the procedures of the CA described in the RoP are in compliance with the requirements/tasks stipulated in the Article 3 of the DMCS, whether the CA follows the RoP and DMCS in its everyday activities;
- Testing the IFR of the TA of the NFP submitted on 13.03.2020;
- Testing the Checklist of the CA about the IFR submitted on 13.03.2020;
- Analyzing the management costs of the PO-s;
- Conducting interviews with the key officials of the CA function and the NFP in Estonia.

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 the CA activities in the practice, the last IFR No 4 of the TA submitted by the NFP on 13.03.2020 was selected by the professional judgements of the auditors, to analyze the costs, which was also the subject of the CA risk-based controls based on the supporting documents.

The auditors compared the tested IFR also with the data in the information system Grace and SFOS.

3. Background information

The CA was assigned to the position of the CA with the MoU-s. The general tasks of the CA in Estonia were stipulated with the Decree of the Government and the DMCS: the functions of the CA are performed by the Norwegian & EEA Certifying Unit of Grants Payments Department and the Head of the CA is the Director General of the SSSC.

The roles and responsibilities of the CA are provided in the Regulations, in particular Article 5.4 thereof:

(a) submitting to the Norwegian Ministry of Foreign Affairs (hereinafter NMFA) /European Economic Area Financial Mechanism Committee (hereinafter FMC) certified IFR-s and final programme reports referred to in Articles 9.3 and 6.12, respectively, certifying that:

- (i) the summary of eligible expenditure submitted by the PO is in full conformity with the supporting documents;
 - (ii) the supporting documents have been examined and found to be authentic, correct and accurate;
 - (iii) the summary of eligible expenditure is based on verifiable accounting which is in compliance with generally accepted accounting principles and methods;
 - (iv) the summary of eligible expenditure falls within eligible expenditure under this Regulations;
 - (v) the summary of expenditure is incurred as part of the implementation of the Programme in accordance with the programme agreement;
 - (vi) sufficient audit trail exists; and
 - (vii) co-financing committed to the programme has been paid.
- (b) submitting to the NMFA/FMC a forecast of likely payment applications as referred to in Article 9.5 of the Regulations;
- (c) declaring to the NMFA/FMC any interest earned as referred to in Article 9.7 of the Regulations;
- (d) taking account for certification purposes of the results of all audits carried out by or under the responsibility of the Audit Authority;
- (e) maintaining accounting records in electronic form of expenditure declared to the NMFA/FMC;

(f) ensuring that funds are made available to the PO-s according to paragraph 2 of Article 9.1 of the Regulations; and
(g) ensuring that amounts recovered and amounts withdrawn following cancellation of all or part of the financial contribution for a programme or project are reimbursed to the NMFA/FMC prior to the closure of the programme.

2. Subject to contrary provision of the national law of the Beneficiary State, the CA shall ensure the establishment and maintenance of a separate interest-bearing bank account dedicated to the FM.

The Article 3.2.1 of the DMCS (agreed with the FMO in 2019) stipulates: the CA checks that the description of POs management costs, expenditure of the funds for bilateral relations and TA in the list of expenditures in SFOS are in line with the eligibility criteria in Article 8 of the Regulation and programme agreements.

The same article describes also the additional tasks of the CA as follows:

- Risk-based verification of the management costs declared by the POs;
- Risk-based verification of expenditure of bilateral fund that is used by the NFP directly;
- Risk based verification of NFP expenditure of TA;
- Verification and analysis of the risk-based monitoring of POs by the NFP.

The abovementioned verifications are separated from the IFR certification process. By the first three tasks above it is obligatory that the CA checks supporting documents risk based.

Where possible, the more detailed work procedures and control check-lists were evaluated by the auditors. Still, some of the work procedures were still in planning phase, including risk-based verification of the management costs declared by the POs, risk based verification of NFP expenditure of TA, the verification and analysis of the risk-based monitoring of POs by the NFP. In those cases, the auditors evaluated whether the principles of the procedures were clearly present in the RoP and asked the sample of the units, which are planned to test and the reasons for the delays.

4. Follow-up and monitoring

The auditee must take into consideration all the findings and recommendations presented in Part B of this report. The CA 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 RECOMMENDATIONS⁶

Key requirement 9: Adequate separation of functions and adequate systems for reporting and monitoring in cases where the responsible authority entrusts execution of tasks to another body.

The MCS-s shall provide for⁷:

(a) the definition of the functions of the entities concerned in management and control and the allocation of functions within each entity;

(b) compliance with the principle of separation of functions between and within such entities;

As the result of this audit, the auditor finds that the MCS of the CA function regarded via the key requirement 9 works well. No improvements needed (Category 1)⁴

Remark No 1 – Decree of the Government is not updated and stipulates that the NFP performs the tasks of the CA (non-significant)

The annex A of the MoU-s provide: „The Norwegian & EEA Certifying Unit of the Grants Payments Department of the SSSC shall act as the CA. The SSSC is administered by the Ministry of Finance of the Republic of Estonia. The CA is directly subordinated to the Director General of the SSSC, who shall act as the Head of the CA. The CA shall be **functionally independent of the NFP**. If the Director General of the SSSC is incapable of carrying out functions as Head of the CA, **these tasks cannot be delegated to the Head of the NFP**. The Statute of SSSC § 17³ (2) provides: „The Norwegian & EEA Certifying Unit of the Grants Payments Department performs the tasks of the CA independently of the NFP and reports to the Director General through the Head of Department.”⁸

Auditors found that the **Decree of the Government § 1 (3)** stipulates: „The Kingdom of Norway, The Republic of Iceland, Principality of Liechtenstein and Republic of Estonia have decided by the memorandum, that NFP performs, in addition to the tasks referred to in Article 5.3 of the Implementing Regulations, the tasks of CA referred to in Article 5.4 of the Implementing Regulations”, **which is not in accordance with the MoUs and the Statue of SSSC**.

NFP explained that the decree has not yet been adjusted since its adoption; and will be amended after larger number of amendments has been collected.

Risk: Due to the inaccuracy in national law, the public may get misleading information.

However, the auditors do not see the risk on the level of performing the tasks of the CA as the SSSC's statue, DMCS and the CA's more detailed procedures are correct and the participants in the process know their rights and obligations. This ensures that the system as a whole works.

Recommendation: The Decree of the Government § 1 (3) should be brought in line with the requirements established for the CA in the MoU and the Statue of the SSSC, according to which the CA must be independent of the NFP and should be directly subordinated to the Director General of the SSSC.

COMMENT FROM THE NFP: The NFP confirms that referred inaccuracy does not pose any risk to the functioning of the management and control system nor implementation of the programmes. Referred provision of the Decree of the Government is explanatory in nature and is not legislative basis for CA. Legal basis of the CAs tasks and setup

⁶ Audit findings are listed according to the order of assessment criteria of the MCS assessment methodology

⁷ Article 5.1 (2) of the Regulations

⁸ Norra ja Euroopa Majanduspiirkonna finantsmehhanismide sertifitseerimisega tegelev toetuste maksete osakonna allüksus täidab SA ülesandeid kontaktasutusest sõltumata ja allub osakonnajuhataja kaudu peadirektorile.

are provided in the MoU, the DMCS and the Statute of the SSSC. The wording of the provision in the Decree of the Government will be updated alongside with other updates (if any).

Key requirement 10: Adequate procedures for drawing up and submitting payment applications.

Article 5.1.2.c of the FM Regulations: The MCS-s shall provide for procedures for ensuring the correctness and regularity of expenditure

Article 5.4.1 of the Regulations on the detailed functions of the CA for declaring the expenditure to the FMO

As the result of this audit, the auditor finds that the MCS of the CA function regarded via the key requirement No 10 **works but some improvements are needed** (Category 2) ⁴

Finding No 2.1 - The CA has certified to the FMO expenditure despite not being able to conduct risk-based checks over the NFP's risk-based monitoring⁹, since the NFP has not carried out risk-based monitoring as defined in the DMCS (non-significant)

The auditors analyzed the requirements on the functioning of the system, RoP and the actual control activities conducted by the CA and NFP and identified the following deficiencies:

No	Provision	Requirement in the Regulations, DMCS	Deficiencies
1	Article 5.3 (3) of the Regulations and Article 2.3.5.1 ¹⁰ of the DMCS	The NFP shall ensure that the programmes are implemented in accordance with the legal framework of the FM and monitor the progress and quality of their implementation. The NFP shall continuously and in a structured manner assess the risks to the implementation of the FM and may take action if necessary and compatible with this Regulation. The details of the risk assessment are stipulated in the Article 2.3.5.1 of the DMCS	1. The NFP has not carried out comprehensive annual risk assessment of the FM as described in the Article 2.3.5.1 of the DMCS. 2. The Annual Performance Analysis of the Administration of the European Structural Funds (signed 05.02.2020) does not include similar analysis for the FM. 3. The NFP has not compiled the monitoring plan or carried out on-spot checks on the implementation of the FM. 4. The RoP does not include the NFP's task to conduct the risk assessment in the demanded categories of the Article 2.3.5.1 of the DMCS
2	Article 3.2.1 of the DMCS	The CA carries out the verification and analysis of the risk-based monitoring of POs compiled by the NFP.	1. The CA confirmed that the CA has not checked the NFP's risk-based monitoring as described in Article 2.7 of the RoP because the NFP has not conducted the risk-based monitoring yet. 2. By certifying the expenditure to the FMO the CA has accepted that the NFP has not conducted the risk-based monitoring.

⁹ Stipulated in the Article 3.2.1 of the DMCS

¹⁰ Article 2.3.5.1 of the DMCS stipulates: once a year, the NFP performs the risk assessment. Risk assessment includes the following **main categories**: implementation system of the programme and management (programme or thematic evaluation, compliance-based monitoring of the PO's obligations PO's implementation of compliance-based monitoring), control system of the PO and programmatic risk. **Risk assessment summary will define the extent of and will be the basis of the monitoring plan** or on-spot checks of the NFP over the PO(s) management and control systems. For the purposes of harmonizing the NFP's monitoring obligation and make it optimal process, the NFP monitoring will be carried out through as part of structural funds monitoring. The NFP sends the risk assessment summary to the CA and the AA for information.

3	Article 3.2.2 of the Financial Guidance	The procedures used by the CA should be set out in procedures manual , identifying which points are checked and referring to checklists to be used.	<p>1. Article 2.2.1 of the RoP does not stipulate which of these procedures of the NFP will be checked by the CA.</p> <p>2. Article 2.7 of the RoP does not specify which NFP's activities (which Articles of the RoP) exactly will be covered by the CA checks.</p> <p>3. According to point 1 and 2 the tasks are not clearly stipulated</p>
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The NFP explained by 28.08.2020 that:

- the CA's procedure in the Article 2.7 of the RoP describes how the CA should make checks about NFP's activities described in the Article 2.2.1 subchapter "Checks on compliance with procedures and legislation"¹¹, **which the NFP has not performed yet;**

- The implementation of the FM is still in the beginning: the NFP has so far performed only risk-based checks on withdrawals and IFR-s as described in Article 2.2.1;

- In addition, the NFP is involved in the coordination and approval of initial and amended DMCS/ procedures / programme agreements and coordination of grant conditions within the programmes. The NFP may get the input for their checks from different sources: annual risk assessments, information from the Supervision department, reports of the irregularities, quality controls of the data in the information system, public media. After analyzing the information with the NFP supervision risk expert, the procedural control procedure is necessary, the corresponding NFP control is also initiated. The NFP intends to compile the Performance Analysis (and if necessary the Action plan with NFP's risk-based inspections) of the Administration of the FM in the same time frame and extent with Annual Performance Analysis on Structural Funds (deadline March 2021).

The auditors take into account that the NFP has so far carried out risk-based checks about the activities regulated in the Article 2.2.1 (2.1) Control of SFOS payments and (2.2) Control of SFOS Withdrawals and that the NFP has advised the PO-s by compiling the DMCS-s by preparatory phase of the Programmes, but these tasks do not replace risk-based monitoring of the NFP as defined with the Article 2.3.5.1 and the CA's checks stipulated in the Article 3.2.1 of the DMCS.

The auditors are in opinion that even in the early implementation phase¹² the NFP shall annually assess the risks of the FM according to Article 5.3 of the Regulations and Article 2.3.5.1 of the DMCS (preferably the Performance Analysis of the FM Administration) to decide the extent of the risk-based monitoring required. There should be clear audit trail about the analyses and decisions made by the NFP. The auditors therefore conclude that the NFP has not followed its obligation under Article 5.3 (3) of the Regulations and Article 2.3.5.1 of the DMCS.

Since the CA relies by certification of the expenditure to the FMO *inter alia* on the risk-based monitoring of the NFP and the CA has annually the obligation to carry out controls over the risk-based monitoring of the NFP (Article 3.2.1 of the DMCS and the Article 2.7 of the RoP), the CA shall monitor whether the NFP has fulfilled its obligations. In case there are deficiencies, the CA should form an opinion about that and ask to eliminate the deficiencies.

RISK: Since the NFP has not carried out the FM Performance Analysis and risk-based monitoring, there is a risk that PO-s are not implementing the programmes in accordance with the requirements of the Regulations and the NFP has no information about that.

¹¹ The full title of the subchapter „Checks on compliance with procedures and legislation and central checks based on SFOS information“

¹² The payments to the projects, management costs of the PO-s and TA are already made.

To determine the scope of the risk, the auditors made the next calculations¹³, based on the data of the IFR-s submitted to FMO via information system Grace:

Programme Operator/ Delegated Body	Programme	Incurred expenditure and advance payments by the outcomes/projects by the end of June 2020 (euros)	Incurred expenditure and advance payments by the outcomes/projects by the end of December 2019 (euros)
Ministry of Education and Research/Estonian Research Council and Archimedes Foundation	Research and Education	3 498 122,00	324 424,00
Ministry of Economic Affairs/ Enterprise Estonia	Competitiveness	691 895,79	110 853,00
Ministry of Social Affairs/State Shared Service Centre	Local Development and Poverty Reduction	105 904,66	0,00
Ministry of Environment/ Foundation Environmental Investments Centre	Climate Change Mitigation and Adaptation	0,00	0,00
Total amount (euros)		4 295 922,45	435 277,00

The total amount of incurred expenditure and advance payments by the outcomes/projects of the PO-s submitted cumulatively to the FMO via information system Grace by the end of the December 2019 were 435 277 euros and by the end of the June 2020 were 4 295 922,45 euros. These sums of the expenditure and advance payments have been checked by the delegated bodies (implementing bodies), but should also be the subject of the NFP's risk-based monitoring. In particular the NFP should monitor the costs related with the activities and expenditure already done (the advance payments should be analyzed after these have covered with real activities and costs).

Taking into account that the Delegated bodies of the POs and PO-s are successfully implementing the projects/programmes of ESIF and significant part of the sums (especially by the Research and Education projects) submitted to FMO are actually advance payments which can be checked on the document level after the real activities have been done, the risk of the ineligible costs of the current early implementation phase is not very high.

If the NFP does not follow its obligations¹⁴, the CA cannot fulfill it's obligations and does not have enough assurance on the eligibility of the expenditure and should not certify the expenditure to the FMO.

RECOMMENDATION TO THE NFP: The NFP should every year conduct systematic risk assessment according to the requirements¹⁴ and decide whether and in which extent the risk-based monitoring of the Norway/EEA FM programmes is necessary. If the analysis does not indicate significant risks requiring mitigation, the NFP may also decide not to conduct risk-based monitoring and should inform the FMO, the CA and the AA about the reasons for that.

RECOMMENDATION TO THE CA: The CA must be convinced that the NFP conducts risk assessment every year according to the requirements¹⁴ and if necessary, the appropriate risk-based monitoring about the FM so that the CA

¹³ Total amount of the expenditure and advance payments of the last IFR's of the PO – management costs of the POs = Incurred expenditure and advance payments by the outcomes/projects of the PO

¹⁴ according to the Article 5.3 of the Regulations, Article 2.3.5.1 of the DMCS, Article 2.2.1 of the RoP

has a basis to confirm the eligibility of costs, functioning of the MCS and certify the costs to the FMO. If the CA detects that the NFP does not fulfil its obligations by assessing the risks and risk-based monitoring the CA should pay the NFP's attention on that and if not getting the needed assurance about the functioning of the system, deny to certify the costs to the FMO till the problems have been solved. The opinion of the CA should be clearly documented, so there would be clear audit trail based on which information got the CA needed assurance to declare the expenditure to the FMO.

The obligations of the NFP and the CA (especially Article 2.2.1 and 2.7) should be more clearly (how the NFP should conduct the risk-based monitoring and how the CA should conduct the controls over the NFP's risk-based monitoring, see also the point no 3 in the table above) defined in the RoP, which is the document to be followed by conducting the everyday procedures of the NFP and the CA.

COMMENT FROM THE NFP: According to the Article 2.3.13 of the RoP NFP conducts risk assessment every year. Risks have been assessed annually and by now due to the very early stage of implementing there have not been risks that would lead NFP to conduct risk-based monitoring. In addition to that programme level risks have also been assessed by NFP when compiling the annual strategic report (Article 2.6 of the Regulation; Article 2.3.10 of the RoP). In the annual strategic report key risks at programme level from the point of view of the NFP are brought out. Information about the programme level risks come from annual programme reports (Article 6.11 of the Regulation; Article 2.3.9 of the RoP) and annual risk assessment documents (Article 2.3.13 of the RoP). When compiling the annual strategic report NFP analyses the programme level risks already assessed by the programme operators and decides which risks are the highest at that point of time and whether additional risks should be assessed and added to the strategic report.

Similarly to Structural Funds NFP is conducting first time this year Annual Performance Analysis of the Administration of the FM (described in Article 2.2.1 of the RoP; EEA/Norway part added, changes approved in November 2020) and the first analysis will be finalized in the beginning of 2021. After that the analysis will be made once every year. The procedure and the timeline will be the same as with Structural Funds. The analysis also involves the analysis of the results of the risk assessment. The analysis will be the basis of the monitoring plan or on-spot checks of the NFP over the PO(s) management and control systems. CA and AA will be informed about the final analysis document which includes the monitoring plan (described in Article 2.2.1 of the RoP; CA/AA notification added, changes approved in November 2020). The NFP amends the monitoring plan when necessary and sends the amendments to the CA and the AA for information. Results of the monitoring will also be reported to FMO in the annual strategic report.

NFP considers that the description of the risk-based monitoring in Article 2.2.1 of the RoP is sufficient. More detailed principles and focus are described before each control.

Responsible Laura Pikkoja, due 30th of March 2021.

COMMENT FROM THE CA:

As stated by NFP the risk assessment has been carried out, but in 2019 it did not lead to any risk-based monitoring due to the early stage of the implementation. CA has fulfilled the obligation to make sure that the risk assessment has been carried out.

CA's verification and analysis of the risk-based monitoring of POs by NFP was added to the DMCS in 2019 (audited version 1.10.2019) after the separation of NFP and CA. Before that it was stated in the DMCS that as NFP is fulfilling the task of CA as well MCS has been set up so that all the monitoring is carried out by NFP.

CA has brought the need for risk-based monitoring of the POs to the attention of NFP. In the beginning of 2020 CA had several meetings with NFP related to that topic. As a result it was decided that Annual Performance Analysis of the Administration, which will be the basis of the monitoring plan, will be carried out in the same timeframe as ESIF

analysis. In that case the data and results of ESIF analysis can be used also for the FM. ESIF analysis is carried out in the second half of every year and approved in the beginning of next year.

As NFP stated the Annual Performance Analysis of the Administration is in the process of being conducted. Dependent on the result of the analysis the risk-based monitoring will be carried out by the NFP in 2021 and CA can carry out its verification to be able confirm the functioning of the MCS.

As the required risk assessment has been carried out by NFP and NFP is in the process of conducting the analysis CA does not see the need to deny certifying the expenditure at this moment.

In the RoP of CA (point 2.7) it is clearly stated that the risk-based monitoring of POs by NFP is carried out by CA and if possible NFPs checklists are used. In CA's opinion the RoP is in line with the requirement in the Financial Guidance point 3.2.2. As the updated DMCS with the mentioned requirement for CA has been in effect for one year and in 2019 there were no risks assessed that would lead to a risk-based monitoring of the POs by the NFP, CA does not agree with the auditor's opinion that this finding is significant.

FINAL COMMENT FROM AA:

The auditors are in opinion that while certifying the expenditure to the FMO, there is currently no clear audit trail based on which information and analyses has the CA got the assurance and formed its opinion that the management and control system has been functioning properly and the costs declared by the programmes are eligible. In case the NFP has not provided CA timely with the required information about the potential risks and the mitigating actions in the system, the CA's opinion to declare the expenditure to the FMO has to be clearly justified and verifiable.

Relying on the documents submitted to auditors, it is not understandable on basis of which information got the CA the assurance to certify the expenditure:

- there is no risk assessment summary (no audit trail) which would define the extent of and would be the basis of the monitoring plan of the NFP over the PO(s) management and control systems;
- the NFP has not conducted the Performance Analysis of the Administration, which should give the basis to compile the monitoring plan of the FM (this obligation has been stipulated in the RoP since November 2020);
- The CA confirmed that they could not check the risk-based monitoring of the NFP, because the NFP has not conducted it.

After getting additional information from the NFP about the risk assessment details of the FM, risk-based monitoring planned for 2021 and amendments made to the procedures of the NFP (in November 2020, *inter alia* the tasks for carrying out Performance Analysis of the Administration of the FM and the CA's obligation to check the POs management costs were added); the auditors got the assurance that the planned monitoring activities are in compliance with the requirements and evaluate the finding as non-significant. The auditors remain the position that the planned risk assessment, risk-based monitoring and checks of the risk-based monitoring should be conducted in compliance with Articles 2.3.5.1 and 3.2.1 of the DMCS; the procedures described in RoP and **sufficient audit trail** of all these processes **should be maintained**.

Finding No 2.2 - The management costs of the Programme Operators in amount of 786 492,47 euros¹⁵ are submitted to the FMO without conducting risk-based verification of the supporting documents by the CA. The RoP of the CA does not include the CA's procedures of risk-based checks of the PO management costs as stipulated in the Article 3.2.1 of the DMCS (significant)

According to the Article 5.1 point 1.c of the Regulations: the MCS-s shall provide for procedures for ensuring the correctness and regularity of expenditure.

The Article 3.2.1¹⁶ of the DMCS stipulates: "the CA checks that the description of POs management costs, expenditure of funds for bilateral relations and TA in the list of expenditures in SFOS are in line with the eligibility criteria in Chapter 8 of the Regulations and Programme agreement. In addition the CA carries out risk-based verification of the management costs declared by the POs by checking the supporting documents. The abovementioned verification is separated from the IFR certification process."

The auditors identified that the CA has checked the descriptions of the POs management costs, but has not conducted risk-based verification of the supporting documents of the management costs declared by the PO-s. It means that by 15.10.2020, according to the database Grace, the management costs of the PO-s in amount of 786 492,47 euros are submitted to the FMO without conducting risk-based verification of the supporting documents by the CA and the CA has not fulfilled it's obligations stipulated in the Article 3.2.1 of the DMCS.

The management costs by the POs, submitted cumulatively to the FMO via information system Grace:

PO/ Delegated Body	Programme	The amount of the PO-s managements costs	
		Submitted to the FMO by September 2020 (about the costs till the end of June 2020), which are paid out by FMO (euros)	Submitted to the FMO by March/April 2020 (about the costs till the end of 2019), which are paid out by FMO (euros)
Ministry of Education and Research/Estonian Research Council and Archimedes Foundation	Research and Education	203 099,00	178 695,00
Ministry of Economic Affairs/ Enterprise Estonia	Competitiveness	421 815,28	238 848,00
Ministry of Social Affairs/State Shared Service Centre	Local Development and Poverty Reduction	69 222,88	21 610,00
Ministry of Environment/ Foundation Environmental Investments Centre	Climate Change Mitigation and Adaptation	92 355,31	73 588,00
Total amount		786 492,47	512 741,00

The auditors also noticed that the RoP does not contain the procedure how exactly should the CA conduct the risk-based checks of the management costs declared by the PO-s: when will it be done (the costs may also include

¹⁵ According to the IFR-s in the Database Grace by 15.10.2020

¹⁶ "Submitting certified IFR-s and final programme reports to the FMO"

advance payments), how often the checks should be conducted, which are the parameters of the sample, which supporting documents should be checked by the CA, how the results will be reported and follow-up will be done.

The same control principles apply also for checking the TA of the NFP. During the audit procedures, the CA explained that they have checked the descriptions of the TA costs and had started the risk-based check of the cost documents in August 2020. The CA forwarded the sample of the expenditure of the TA of the NFP and confirmed that the risk-based checks of the management costs of the PO-s will be based on the same methodology and the procedure will be started as soon as the risk-based checks of the costs of the TA of the NFP are finalised.

RISK: Since the RoP does not include CA's procedures of the risk-based checks of the management costs of the PO-s and the control procedures itself in sufficient detail, there is the risk that the tasks stipulated in the DMCS Article 3.2.1 will not be conducted (on time) and/or in sufficient scope; and the CA may certify ineligible costs to the FMO.

Taking into account the explanations given by the CA on conducting the checks, the auditors see here also the risk of available resources on the level of CA or planning the CA's workflow as the checks described should already have been done.

RECOMMENDATION:

The CA's task to carry out risk-based checks also for the management costs of the POs should be added to the RoP; as well as the detailed procedures how the checks on the level of the cost documents will be carried out, including the sampling procedures.

The CA should certify the next IFR-s to the FMO only after all the abovementioned CA's risk-based checks on the level of supporting documents of the PO's management costs¹⁷ are finalized and the CA is convinced that the expenditure is eligible.

The checks shall be planned as regular activities in the CA's annual work-plan.

COMMENT FROM THE CA:

CA's verification of the management costs declared by the POs was added to the DMCS in 2019 (audited version 1.10.2019) after the separation of NFP and CA. Before that it was stated in the DMCS that as NFP is fulfilling the task of CA as well MCS has been set up so that all the monitoring is carried out by NFP. Therefore, CA does not agree that this verification should have been done already.

CA started with the risk-based verification of NFP's expenditure. As this verification is being finalized CA started planning the verification of POs management costs. It was planned to add the description of the verification to the RoP at the planning stage of the verification. The description of the verification was added to the RoP point 2.6 in November 2020 and CA is in the process of making the sample for the verification. The POs management costs will be verified by CA once a year.

It is stated in the DMCS that the verifications are separated from the IFR certification process. Therefore, the finalisation of the verification is not prerequisite for certification. CA aims to finish the verifications by the time next IFRs are to be submitted to the FMO.

As the updated DMCS with the mentioned requirement for CA has been in effect for one year, the description of the verification has been added to RoP and CA has started the verification process, CA does not agree with the auditor's opinion that this finding is significant.

¹⁷ Also the CA's risk-based checks of the TA of the NFP and (if appropriate) the fund for the bilateral relations used by NFP should be finalized.

ADDITIONAL COMMENT FROM THE AA:

Considering that the CA shall be aware of the obligation to conduct risk-based controls over management costs of the POs on the level of the supporting documents already more than a year ago (the obligation for the CA was stipulated in the Article 3.2.1 of the draft DMCS submitted to the FMO on 1.07.2019); the management costs of the POs have been certified to the FMO during several years already in total amount of 786 492,47 euros¹⁸ and there have not been any risk-based controls on the level of supporting documents; the auditors remain the position that the finding is significant.

The auditors checked that carrying out the risk-based controls of the management cost of the POs as a task of the CA have been added to the RoP point 2.6 in November 2020, which should prevent this type of error in the future. Since the CA has started with the risk-based checks of the management costs of the POs by checking the supporting documents, the results of the checks shall be available before certifying the next IFR, the potential ineligible costs should be found out before the next certification to the FMO and the risk for ineligible expenditure decreased.

Key requirement 11: Appropriate computerized records of expenditure declared and of the corresponding public contribution are maintained;

Article 5.1.2.d of the Regulations that the MCS-s shall provide for reliable accounting, monitoring and financial reporting systems in computerized form;

Article 5.4.2 of the Regulations on the establishment and maintenance of a separate interest-bearing

bank account

As the result of this audit, the auditor finds that the MCS of the CA function regarded via the key requirement 11 works well. No improvements needed (Category 1)⁴

Key requirement 12: Appropriate and complete account of amounts recoverable, recovered and withdrawn;

The MCS-s shall provide for reporting and monitoring procedures for irregularities and for the recovery of amounts unduly paid¹⁹.

As the result of this audit, the auditor finds that the MCS of the CA function regarded via the key requirement 12 works well. No improvements needed (Category 1)⁴

¹⁸ which covers a significant part (17%) of the whole budget of the PO's management costs

¹⁹ Article 5.1 (2 h) of the Regulations

ANNEX 1 – Summary opinion of the auditee’s MCS

Key requirement	Category 1	Category 2	Category 3	Category 4
<p>Key requirement 9: Adequate separation of functions and adequate systems for reporting and monitoring in cases where the responsible authority entrusts execution of tasks to another bod.</p> <p>Article 5.1 (2) of the FM Regulations: The MCS-s shall provide for:</p> <p>(a) the definition of the functions of the entities concerned in management and control and the allocation of functions within each entity; compliance with the principle of separation of functions between and within such entities;</p> <p>(b) compliance with the principle of separation of functions between and within such entities;</p>	X			
<p>Key requirement 10: Adequate procedures for drawing up and submitting payment applications</p> <p>Article 5.1.2.c of the FM Regulations: The MCS-s shall provide for procedures for ensuring the correctness and regularity of expenditure</p> <p>Article 5.4.1 of the Regulations on the detailed functions of the CA for declaring the expenditure to the FMO;</p>		X		
<p>Key requirement 11: Appropriate computerized records of expenditure declared and of the corresponding public contribution are maintained;</p> <p>Article 5.1.2.d of the Regulations that the MCS-s shall provide for reliable accounting, monitoring and financial reporting systems in computerized form;</p> <p>Article 5.4.2 of the Regulations on the establishment and maintenance of a separate interest-bearing bank account</p>	X			
<p>Key requirement 12: Appropriate and complete account of amounts recoverable, recovered and withdrawn;</p> <p>Article 5.1 (2 h) of the FM Regulations: The MCS-s shall provide for reporting and monitoring procedures for irregularities and for the recovery of amounts unduly paid.</p>	X			
Summary opinion of the auditee’s MCS		X		