



Allocation and use of the funds from the state budget program “Contingency Funds” for media support to mitigate the consequences of COVID-19 crisis

Interim report



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Inspections carried out and an interim report drafted within the framework of the financial audit "On the accuracy of the 2020 annual report of the Social Integration Fund" (Audit schedule No 2.4.1-31/2020 of the Fifth Audit Department of the State Audit Office of 6 July 2020) and following Sub-paragraph c), Paragraph 3, Section 3 of the State Audit Office Law.

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Why have we drafted this interim report?

Since International Standard on Auditing (ISA) 701, Communicating key audit matters in the independent auditor's report¹, has taken effect, the State Audit Office is required to assess the need to include key audit matters in the audit opinion on the financial statements.

For the purposes of those standards, key audit matters are matters that, in the auditor's professional judgment, are significant in the context of the audit of the financial statements of the reported period that one reports to the management of an audited entity and that have been the focus of the auditor's attention. There is no separate opinion on the key audit matters issued.

The information provided on key audit matters serves as additional information for potential users of the financial statements. It helps apprehend both matters that the auditor has identified as significant in the professional judgment and the audited entity and the areas where the management of the audited entity has made significant judgments while drafting the audited financial statements. This information may also serve as a basis for potential users to communicate further with the management of the audited entity about specific aspects of governance, audited financial statements, or audits performed.

The solidity and actual spending of the requests for additional funds allocated to address the consequences of COVID-19 are the key audit matter, which is crucial in all financial audits on the accuracy of drafting the annual consolidated financial statements for 2020 ministries and central governmental agencies.

In 2020, COVID-19 pandemic affected Latvia like the rest of the world. The Cabinet of Ministers adopted a decision to declare the emergency on 12 March 2020, which continued until 9 June 2020² and was declared once again on 9 November 2020³. The extraordinary circumstances caused by COVID-19 affected the daily lives of the government, the public, and everyone both during and after the emergency. The new conditions required the ability to react and adapt quickly and caused deviating from the usual order. Under the new conditions, the institutions should have been able to coordinate their activities more intensely and cooperate with each other by avoiding legal formalism and the departmentalism to ensure the functioning of the state and the protection of each individual in emergency conditions.⁴

Overcoming the COVID-19 pandemic and dealing with its consequences have required significant funds from the state budget. Since the declaration of the state of emergency, the Cabinet of Ministers has made decisions in connection with overcoming the crisis caused by COVID-19 and eliminating its consequences on the allocation and reallocation of state budget funds for the implementation of basic functions for 1,096,294,453 euros in total by 6 November 2020 and has examined proposals for reallocation of funds for the performance of projects and measures co-financed by European Union policy instruments and other foreign financial assistance for 496,000,000 euros⁵. The State Audit Office pays special attention to assessing the spending of state budget funds allocated for overcoming the COVID-19 pandemic, preventing, and mitigating its consequences.

The Cabinet of Ministers has allocated⁶ funding of 1,040,928 euros to the Social Integration Fund for overcoming, mitigating, and preventing the consequences of COVID-19 from the state budget program "Contingency Funds" between 12 March 2020 and 31 July 2020 to safeguard the operation of the Media Support Fund and the opportunity for the public to receive comprehensive information and opinions on curbing the COVID-19 crisis, as well as to ensure the security of the

national information space and support in connection with the delivery costs of subscribed press publications (joint-stock company Latvijas Pasts) and the broadcasting costs of electronic mass media.

To provide information on the key audit matter raised in the financial audit "On the accuracy of the 2020 annual report of the Social Integration Fund" – solidity and actual spending of the requests for additional funds allocated to curb the COVID-19 consequences, the State Audit Office audited and drafted this interim report on the funding of 1,040,928 euros granted to the Social Integration Fund for media support.

Summary

The audit assessed the use of the funding allocated from the budget program "Contingency Funds" to the Social Integration Fund (hereinafter - SIF) of 1,040,928 euros. One has disbursed the funding through tenders to safeguard the continuity and capacity building of commercial press and digital media and the production of public domain content during an emergency so that the public can receive comprehensive information and views on overcoming the COVID-19 crisis.

When allocating the funds to the SIF for media support, the Cabinet of Ministers has not set criteria for allocating funding to the media in either internal or external laws or regulations. This situation differs from other solutions for mitigating the consequences of the COVID-19 crisis, such as downtime benefits administered by the State Revenue Service (hereinafter - SRS), where the support criteria and legal framework are clearly defined in external legislation.

In their turn, when allocating state budget funding for implementing the SIF Media Support Fund program in previous years, the Ministry of Culture entered into an agreement with the SIF setting out clear procedures for the use of funding and criteria for providing support.

In the absence of regulatory criteria for allocating funding to the media, the SIF defined those criteria itself. According to them, one allocated the funding from the state budget program "Contingency Funds" to general media support basically. Whereas, according to the Information Report prepared by the Ministry of Culture on support solutions to mitigate the negative effects of the COVID-19 crisis on the media sector (hereinafter referred to as the Informative Report), a loss of at least 30% was the only advantageous criterion, the SIF tender regulations under which the tenderers' bids were evaluated, the integrated evaluation criteria in fact allowed granting the funding to the media with any amount of reduction in revenues.

Despite the fact that the SIF had required tenderers to justify the reduction in revenues with a statement of account turnover for the period from 14 March 2019 to 14 April 2019 and for the period from 14 March 2020 to 14 April 2020, the SIF has not ascertained the veracity of the information provided when assessing tenders in cases where tenderers had submitted only estimates or evidence of a reduction in revenues.

As the information on actual media revenues in the periods specified in the SIF tender regulations was not available in external databases, the auditors of the State Audit Office requested

information from the SRS on the amounts of revenues indicated in the value-added tax returns of mass media in March and April 2020 and March and April 2019 to identify trends in declining actual revenues over those periods.

In the inspections performed, the auditors established that the reduction in revenues in the respective periods certified by tenderers in at least 88 project applications out of 110 project applications in total did not correspond to a decrease in revenues presented in their value-added tax returns submitted to the SRS.

As the quality criteria incorporated in the SIF tender regulations allowed funding to be granted to mass media with any amount of reduced revenues, having re-evaluated the tenderers' revenues according to the information provided by the SRS, we found that support was actually granted to 66 projects where the tenderers' reduction in revenues was less than 30%:

- ✓ Revenues of 5 tenderers in 7 projects totalling to 22,533.16 euros in the specific months of 2020 have not decreased or even increased compared to 2019;
- ✓ Reduction in revenues of 45 tenderers in 47 projects totalling 369,918.11 euros have reduced up to 20% in specific months of 2020 compared to 2019;
- ✓ Reduction of revenues for 9 applicants in 12 projects totalling to 78,411.91 euros ranged from 20% to 30% in 2020 compared to 2019.

Besides, considering the explanations the SIF provided at the time of drafting this interim report and the rules incorporated in the tender regulations, they applied the minimum threshold of quality criteria for the provision of mass media support only in the third round of the tender. Following this approach, they endorsed the tenderers' applications with any score received in the quality evaluation and regardless of the reduction in revenues in the first round and the additional call. Should the minimum threshold of quality criteria have been applied from the beginning of granting support, six tenderers, who have been awarded funding in the total amount of 60,000 euros, would not be qualified to receive support according to the data provided by the SRS.

The State Audit Office also inspected the control performed by the SIF randomly on the use of the allocated funding following the provisions of the tender regulations. In 6 projects out of the 40 projects examined (See Annex 4), one identified discrepancies which led the SIF to cover costs not provided for in the tender regulations or incurred during the period for which no financial support was foreseen. As a result, there are 2,599 euros from the state budget funds spent unduly.

On 7 April 2020, the Cabinet of Ministers reviewed the Informative Report of the Ministry of Culture informing the government about the significant impact of the emergency in the country related to COVID-19 and its containment measures in 2020 on the mass media sector. The Ministry of Culture pointed out that although the state of emergency did not stop the provision of mass media services like in the tourism, culture, and entertainment sectors, the emergency had a significant impact on the advertising sector, which was the main source of revenue for mass media thus reducing the revenues of mass media outlets.

Taking into account Cabinet Order No 103 "On the declaration of a state of emergency" of 12 March 2020, the Cabinet of Ministers issued Cabinet Order No 160 "On the allocation of financial resources from the state budget program "Contingency Funds", which allocated 1,040,928 euros to the SIF on 7 April 2020. Those funds were intended for ensuring the operation of the Media

Support Fund and to provide the public with comprehensive information and views on overcoming the COVID-19 crisis, providing the security of the national information space in the press and commercial Internet news portals, and providing support regarding the delivery costs of subscribed press publications and the broadcasting costs of electronic mass media.

The financial audit examined the solidity and actual use of funds allocated to the SIF for media support to mitigate the consequences of COVID-19 crisis.

The audit has established that the laws and regulations did not set any criteria for using the funds allocated to the SIF based on which the mass media outlets could apply for state support to overcome the COVID-19 crisis.

Following the Law on the Social Integration Fund⁷, the SIF is a derived legal public entity (public foundation) operating under the Law on the Social Integration Fund, other laws and regulations, and the SIF Statutes approved by the Cabinet of Ministers. The Fund aims to support financially and facilitate the society's integration according to the development planning documents. Neither the Law nor other laws and regulations determine the Fund's competence to implement mass media policy, including providing financial support to the mass media.

When without the competence specified in laws and regulations, the SIF has implemented mass media support and has disbursed the funding to ensure the continuity of commercial print and digital media outlet operations and capacity building, one identifies non-compliance with this principle of the rule of law enshrined in the Law. In addition, given that funding for the mass media is provided through the administrative deeds what the SIF issues, non-compliance with the rule of law runs the risk of adverse administrative deeds be appealed. According to Section 11 of the Administrative Procedure Law, an institution may issue an administrative deed unfavourable to an individual or perform the act based on the Latvian Constitution, law, and international law provisions. Cabinet Regulations or binding regulations of local or regional governments may be the basis for such an administrative deed or actual action only if the Latvian Constitution, law or provision of international law includes an authorisation for the Cabinet of Ministers for issuing regulations or for local and regional governments for issuing binding regulations directly or indirectly and provide such administrative deeds or actual actions therein.

Although the tender regulations organised by the SIF stipulated that funding would be available as a priority to those mass media that would be able to prove a 30% reduction in revenues compared to the corresponding month of 2019, we found during the assessment of the quality evaluation criteria envisaged in the tender regulations, we found that the mass media actually were able to qualify for funding irrespective of their reduction in revenues because the SIF had also identified a reduction in revenues up to 20%, between 20% and 30%, and above 30% as a quality criterion. Also, by setting other formal quality evaluation criteria in the tender regulations that were not related to the reduction in revenues due to the consequences of the COVID-19 crisis, and by carrying out a formal evaluation of tenders in some cases when evaluators did not substantiate their evaluation (score awarded), they granted funding to almost all tenderers who had applied for the financing.

To find out the reduction in revenues of tenderers in March and April 2020 compared to March and April 2019, the State Audit Office requested and received information from the SRS on the

revenues declared in the value-added tax returns of 88 tenderers in the respective months of 2019 and 2020.

When assessing the reduction in revenues of mass media outlets according to the information provided by the SRS on revenues in March and April 2020 compared to revenues in the respective months of 2019 during the audit and taking into account the tender regulations set by SIF, we discovered that the Fund has also supported such five tenderers with total funding of 22,533.16 euros, whose revenues in the specific months of 2020 have not decreased at all or have even increased compared to 2019.

There were also 45 tenderers granted funding of 369,918.11 euros, whose reduction in revenues ranged from 10 to 20% in the specific months in 2020 compared to 2019. In their turn, nine tenderers, whose revenues decreased by 20 to 30% in the particular months in 2020 compared to 2019, have received a total of 78,411.91 euros.

Although the SIF had required tenderers to justify a reduction in revenues with a turnover statement of their accounts, the audit found that the SIF had not verified the revenue information provided by the tenderers regarding the genuineness of the reductions when assessing tenders in cases where tenderers had submitted only calculations or evidence of a decline in revenues.

When comparing the data submitted to the SRS with the information that the tenderers had submitted during the tender organised by the SIF, we established that the reduction in revenues confirmed in the tenders of 66 tenderers (See Annex 2) in the respective periods was less than 30% and did not correspond to the income presented in tax returns submitted to the SRS.

As a result, according to the auditors' calculations of reduction in revenues according to SRS data, as well as project re-evaluation, we conclude that at least six project applications would not receive the minimum number of 11 points (See Annex 3) and could not qualify for support according to the initial explanation by the SIF. The total amount of funding allocated to those tenderers is 60,000 euros or 5.8% of the total funding allocated to support the mass media.

When this interim report was drafted, the SIF changed its initial explanation regarding evaluating the project applications received under the first and additional tenders by stating that the minimum threshold of 11 points was applied only to the third tender.

The evaluation of the explanations provided by the SIF about the definition and assessment of the criteria revealed that the tenderers could with any score received in the quality evaluation regardless of their reduction in revenues could receive support.

The audit concluded that one had not performed the control of the concluded agreements on the use of funding properly because by accepting the reports on the use of the allocated funding, the SIF allowed six tenderers to include 2,599 euros of ineligible costs in the reports.

In view of the above, the audit did not provide assurance on the use of the funding supplied by the state budget program "Contingency Funds" to compensate the mass media for the reduction in revenues caused by the COVID-19 crisis to ensure their operation.

The State Audit Office also evaluated the allocation, and use of financial resources from the state budget program "Contingency Funds" for mass media support at the National Electronic Mass Media Council. The interim report of the performed audit will be available on the website of the State Audit Office <https://www.lrvk.gov.lv/lv>, in the section "Audit reports".

Recommendations and proposals of the State Audit Office

In total, the audit provides two recommendations to the SIF, whose implementation will improve the control over the allocation and use of funding for programs financed from the state budget.

We will submit a proposal to the Cabinet of Ministers to establish common criteria for allocating funds for further support of the mass media from the state budget program “Contingency Funds” to mitigate the consequences of the COVID-19 crisis while encouraging entrusting the administration of funding to one state institution.

References

- ¹ The International Organisation of Supreme Audit Institutions (INTOSAI) also uses International Standards on Auditing for the financial audits; hence, the latter are binding on the State Audit Office, which conducts audits in accordance with international standards on public sector auditing.
- ² Cabinet Order No 103 “On Declaring a State of Emergency” of 12 March 2020.
- ³ <http://tap.mk.gov.lv/lv/mk/tap/?pid=40494077&mode=mk&date=2020-11-06>.
- ⁴ Communication of the President of Latvia No 8 “Basic Principles of Activities of State Constitutional Bodies in an Emergency Situation” of 23 March 2020.
- ⁵ Informative report of the Ministry of Finance on reallocation of the financing from the EU Structural Funds and the Cohesion Fund and solutions for mitigating the consequences of COVID-19, reviewed by the Cabinet Meeting on 19 May 2020.
- ⁶ Section 2 of Cabinet Order No 160 “On the Allocation of Funding from the State Budget Program “Contingency Funds”” of 7 April 2020.
- ⁷ Section 2.1 of the Social Integration Fund Law.