



**Annual Report of
the State Audit Office
of the Republic of Latvia
2010**

LIST OF CONTENTS

Foreword by Auditor General	3
1. Mission, Vision, Values and Objectives of the State Audit Office	4
2. Legal Regulation and Structure of the State Audit Office	5
3. Implementation of the State Audit Office Operational Strategy	7
3.1. Improvement of the Public Sector Management	7
3.2. Ensuring Sustainability of the State Audit Office Development	16
4. Results of the State Audit Office Audits	26
4.1. Legality Audits	26
4.2. Financial Audits	45
5. Priority Areas of Activity for the Next Year	50
Annex 1. Budget of the State Audit Office	52
Annex 2. The Audits and the Compliance Tests Performed at the State Audit Office in 2010	53

Annual Report 2010

Dear readers,

Following its mission to serve the public interest the State Audit Office (SAO) performs supervision over the lawful, useful and efficient use of State funds.

The budget consolidation measures carried out in the recent years have also significantly affected the State Audit Office's capacity to act, as a result of which the number of the audits performed has decreased. Last year, the SAO completed a total of 43 audits, of which 26 were financial audits and 17 were legality audits.

The audit work performed by the SAO is based on the belief that the implementation of recommendations issued during the audits is the main outcome, which promotes good overall state governance – rather than the number of deficiencies, contraventions detected during inspections or the size of penalties imposed. Therefore, the accomplishments of the audited entities in compliance with the recommendations provided previously are carefully assessed. In 2010, the audited entities had to implement a total of 869 audit recommendations, of which only 73% were implemented; 23% were in the implementation stage; and 4% of the recommendations were not implemented at all. The recommendations that were implemented have promoted further improvements in the management of State finances and legislation, enhancement of State administration activities and better access and quality of the services they provide, an increase in State budget revenues and the discontinuation of unproductive and ineffective activities.

In order to achieve results and sustainability oriented management of State resources – the SAO expresses a certain point of view – it is necessary to define a vision and objectives for the development of the country. In order to introduce its position, the SAO has been proactive in developing specific suggestions for changes in regulatory enactments. The proposals developed provide for fundamental changes in the policy and State budget formation processes practised and stipulate that State policies and achievable results should be approved first, in accordance with which resources are then planned, including strict accountability for the achieved results. The initiative by the SAO gained support in the Saeima (Parliament) of the previous convocation, and a working group was set up under the leadership of the Chairman of the 9th Saeima to ensure its further progression. To ensure that the issue does not stop, we have also addressed the appropriate committee of the current convocation of the Saeima.

At a time when it is essential for the State to operate with the resources at its disposal with maximum efficiency, the SAO has paid special attention to the governance of State capital companies. For two years running now, upon completion of financial audits of the annual report of the Republic of Latvia for the fiscal year, the SAO has invited the Cabinet of Ministers to draw Saeima's attention to the necessity of a State capital management policy, in order to achieve maximum returns on the capital invested. As a result of the activities by the SAO, the Saeima has issued notices instructing the Cabinet to resolve this issue; however, the execution of this assignment was not yet assured by the end of last year.

The SAO is convinced that comprehensive and result oriented national development requires a change in the policy of State governance – whereby it is exclusively subordinated to State interests. For this reason, the SAO will continue to follow to ensure that operations with State resources are lawful and efficient, that decisions are made in a fair, transparent and responsible way and in accordance with the needs of the public and the common welfare.

Inguna Sudraba
Auditor General of the Republic of Latvia

Annual Report 2010

1. Mission, Vision, Values and Objectives of the State Audit Office

The State Audit Office is an independent collegial supreme audit (inspection) institution, an essential constituent of the financial system serving public interests by ensuring supervision over efficient and effective utilisation of State and local government resources.

The State Audit Office is one of the six constitutional government bodies in Latvia and is subject only to the law.

Mission

To promote:

- Efficient and legitimate utilisation of public resources (tax payers' money);
- Development of financial management and responsibility for utilised resources;
- Honest and transparent decision making process in the public sector.

Vision

Assist the State in wise management and utilisation of resources.

Values of the State Audit Office

Responsibility, transparency and development.

Objectives

Through its action, the State Audit Office:

- Promotes development of State's financial control system;
- Promotes observance of the laws;
- Reduces risk of errors and violations;
- Promotes development of internal audit and increased responsibility of internal audit services;
- Promotes improvement of internal control system;
- On the basis of audit conclusions, advances improvement of laws and other regulatory enactments.

In order to ensure implementation of the set objectives and in accordance with the State Audit Office Law, the State Audit Office:

- Each year provides an opinion to the *Saeima*¹ regarding the financial year report submitted by the Minister for Finance on the implementation of the State budget and the budgets of local governments (the financial position thereof);
- Each year provides opinions on correctness of annual report preparation by ministries and other central State institutions;
- Submits a report to the *Saeima* and the Cabinet regarding financial audits of audited entities, which have received qualified or adverse audit opinion or disclaimer of audit opinion by the State Audit Office; regarding all performance audits conducted by the State Audit Office; regarding particularly important and significant findings;
- Reports to State institutions regarding findings that affect activities of the respective institutions, as well as to law enforcement institutions regarding violations of legal norms disclosed during the audits;
- Within the scope of its competence cooperates with the European Union institutions and other international organisations or institutions.

¹ The Parliament of the Republic of Latvia

2. Legal Regulation and Structure of the State Audit Office

Legal Status of the State Audit Office

Article 87 of the Constitution of the Republic of Latvia specifies that the State Audit Office is an independent, collegial institution; Article 88 stipulates that the organisation and responsibilities of the State Audit Office shall be provided for by a specific law.

The activity of the State Audit Office is regulated by:

- The State Audit Office Law (adopted by the *Saeima* on 9 May 2002, with amending laws of 9 December 2004, 22 June 2005, 12 December 2008, 17 September 2009 and 1 December 2009);
- By-law of the State Audit Office (approved at the meeting of the State Audit Office Council on 3 October 2005, amendments of 19 December 2005, 12 February 2007, 29 October 2007, 17 March 2008, 18 July 2008, 5 January 2009, 2 March 2009, 23 March 2009, 31 August 2009, 7 December 2009, 26 July 2010 and 7 February 2011.).

In accordance with the State Audit Office Law, the State Audit Office itself determines the audited entity, audit time period, type and objective of an audit.

Rights of the State Audit Office

In accordance with the State Audit Office Law, the State Audit Office is entitled to receive draft regulatory enactments examined by the *Saeima* and the Cabinet and provide opinions of such, if the regulatory enactments may affect the revenue and expenditure of the State and local governments or if such enactments provide for action with the property of the State, as well as with the resources allocated by the European Union and other international organisations or institutions.

Auditor General, a member of the Council of the State Audit Office, Head of Sector of an Audit Department and employees authorized by the Auditor General may without hindrance visit institutions and undertakings (companies) irrespective of their subordination and ownership and request all necessary information in order to perform the task of the State Audit Office.

Upon the request of the State Audit Office, banks and other credit institutions shall have the duty to provide the State Audit Office in the amount and according to the procedures determined by *Credit Institution Law*, with the information requested by it with respect to the accounts and transactions performed by the audited entities, if such is necessary in order to perform an audit.

Structure and Personnel of the State Audit Office

The State Audit Office is comprised of the Auditor General, the Council of the State Audit Office, audit departments and support structural units.

The Auditor General is appointed to the position for four years by the *Saeima*, members of the Council are appointed in accordance with recommendation of the Auditor General for four years by the *Saeima*.

The Auditor General is the Chairperson of the Council. The Auditor General appoints Directors of Audit Departments and Heads of Sectors of Audit Departments, defines the audit standards that shall be used by the State Audit Office in accordance with the international standards recognised in the Republic of Latvia, audit methodology and

Annual Report 2010

requirements for audit quality control, as well as undertakes responsibility for establishing internal control and internal audit system.

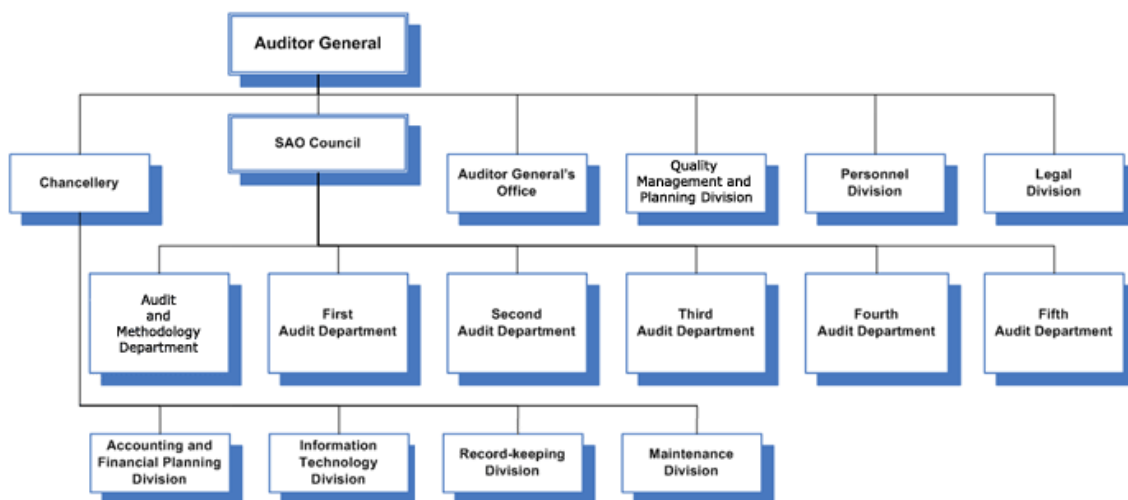
The Council approves the by-law and other regulatory enactments that regulate internal performance of the State Audit Office, as well as Annual Audit Plan and Strategic Development Plan; decides on distribution of audit fields among the departments, and approves audit reports that have not been approved by the audit departments.

Directors of the Audit Departments examine and approve the results of audits, audit reports and opinions.

Heads of the support structural units ensure effective execution of the institution's basic functions.

The auditors are employees of the State Audit Office, who perform audits and develop audit reports and opinions, render recommendations reasoned by audit findings and conclusions, and ensure supervision of implementation of audit recommendations.

Figure 1. The Structure of the State Audit Office



The structure of the State Audit Office was modified during the reporting period, which marked continued efforts to improve and optimise the operations of the institution. The activity planning and quality management supervision functions were merged, transferring them from the Audit and Methodology Department to the Quality Management and Planning Division. The Internal Audit Division was abolished, and an Audit Commission was established, which oversees the evaluation of the quality and effectiveness of the internal control system. Changes also took place in the First Audit Department, in which the areas of audit were revised and merged, thus reducing the number of sectors within the department.

At the end of 2010, just as the year before, there were 163 official positions at the State Audit Office. As of 31 December 2010, the actual staff numbered 159, of those 120 audit staff and 39 support staff.

As of 31 December 2010, 16 employees of the State Audit Office continued studies at higher education institutions, including eight from audit staff and eight from support staff.

3. Implementation of the Operational Strategy of the State Audit Office

The directions of development, objectives and achievable results of the State Audit Office have been established in the *Operational Strategy of the State Audit Office for 2010-2013*, adopted in 2009 (hereinafter: the Strategy).

The Strategy defines two main areas of activity in accordance with the long-term needs of the State Audit Office:

- improving governance of the public-sector;
- assuring sustainability of the development of the State Audit Office.

Sub-areas and corresponding objectives have been specified for each area of activity, whereas achievable results have been set for the implementation of the objective.

According to the operational strategy objectives and the approved audit themes of the State Audit Office, the Office drew up an operational plan that incorporated both audit work and support activities. The operational plan defines the achievable results, the steps to be undertaken in order to achieve them, responsible executives, the execution timeframes, as well as planned man-hours and budget. Thus, the administration of the State Audit Office has complete information regarding the cost of achieving the necessary outcomes, and the operational plan contains complete information regarding the contributions of each structural unit to the achievement of the overall objectives of the State Audit Office.

3.1. Improvement of Public-Sector Governance

Long-term strategic objectives

The following long-term strategic objectives have been defined for the improvement of public-sector governance: (1) the activities of the State Audit Office facilitate the effectiveness of financial management; (2) audit themes correspond to the public interest; and (3) audit methodology is consistent with the best practice and international trends.

With the aim to achieve the first objective – **to facilitate the effectiveness of financial management** – in accordance with the audit methodology of State Audit Office, in 2010 audited units were provided with specific and substantial recommendations arising from the findings and conclusions of the audits, assessing financial impact where possible.

State Audit Office audit recommendations were provided regarding the following areas:

- adjusting the requirements prescribed by regulatory enactments, creating a clear interpretation of the provisions of the law;
- development of an accounting policy or improvements thereof in accordance with the requirements of regulatory enactments;
- improvement of human resource management in the state administration;
- improvement of state and municipal procurement procedures in accordance with the Public Procurement Law;
- improvement of the quality and accessibility of public services;
- adjusting information technologies and systems in the audited fields;
- ensuring efficient use of State and local government budget funds, discontinuation of unproductive and ineffective activities.

Annual Report 2010

Following the previously conducted audit regarding the 2009 annual report of the Republic of Latvia on the implementation of the State budget, the State Audit Office has issued recommendations whose implementation substantially improves the overall financial management of the State administration:

- in order to ensure the efficient and economical use of State budget funds in accordance with the prescribed objectives – for the Ministry of Finance - to undertake the necessary measures, including changes in regulatory enactments for connection of the State budget planning and implementation process with the objectives specified in policy planning documents, achievable results and performance indicators, as well as to raise accountability of the management of ministries and other central government institutions for the achievement of the objectives, results and performance indicators specified in the State budget process and policy planning documents;
- in order to ensure common implementation of the State human resources policy – for the Cabinet – to develop a strategic document that would be connected to the provisions of the medium-term development planning document and would provide the achievable objectives and results of the human resource management process in State administration as a whole and at each individual State institution;
- in order to ensure efficient governance of State and municipal capital companies and returns on the capital invested – for the Ministry of Finance – in cooperation with the ministries and local governments to develop a State and municipal asset management policy, defining the aim of State and municipal financial investments, the expected operational performance of State and municipal capital companies and methods to achieve mentioned performance.

Following the financial and legality audits conducted in 2010, the State Audit Office has issued the following substantial audit recommendations, the implementation deadline of which is the year 2010 and the subsequent years:

- to the Ministry of Finance:
 - in the next programming period, to stipulate that in the planning process of the State budget, the State budget funds required for the implementation of the European Union funds should be budgeted in full amount as part of the budget of each ministry or central state institution; that the planning process should be connected with the objectives and achievable results defined in the policy planning documents, thus ensuring the sequential implementation of correlative activities;
 - to initiate amendments in the regulatory enactments to provide that, in holding companies where a State capital company is the parent company, dividends for transferring into the State budget shall be calculated from the consolidated profits;
 - to initiate amendments in the regulatory enactments to provide that all taxpayers pay the personal income tax into an appropriation account of the Treasury, and all local governments receive the personal income tax from the Treasury's appropriation account in accordance with the tax revenue share coefficient of the respective local government, as specified by the regulatory enactment;

Annual Report 2010

- to undertake measures in cooperation with the State Revenue Service to ensure that taxpayers are required to submit only information that is not available within the State information systems, by evaluating and optimising tax reports and forms accordingly;
- to take the necessary steps to ensure that State budget revenues are accounted using the accrual principle, as prescribed by the International Public Sector Accounting Standard, “Revenue from non-exchange transactions (taxes and transfers)”, as well as to define the process for administering fees in the regulatory enactments;
- to specify in detail the content of the explanations to be attached to annual reports in the annual accounts regulations, providing that information must be disclosed regarding immovable property at pawn, thus ensuring that the State consolidated accounting balance sheet provides accurate, complete and comparable information regarding State and local government assets;
- to the Ministry of Culture: to assess the possibility of making changes in the design and functionality of the premises of National Library of Latvia and to take steps to ensure that funding is planned for the overall project, thus achieving savings of State budget funds of LVL 87 million;
- to the Ministry of Education and Science:
 - to adjust the regulatory enactments prescribing common criteria for allocating State budget funding and a single process for sports federations to carry out sports events and to receive support for sports structures;
 - to ensure that the cooperation agreements with sports organisations specify achievable results for sports organisations and procedures according to which sports organisations report to the Ministry on the achievement of such results;
 - to undertake measures for establishing the remuneration intervals to be funded from the State budget and criteria for allocating these within sports organisations, and a system of work remuneration to be disbursed from State budget funds to salaried athletes, coaches and auxiliary athletic staff, where such expenditure items are paid from State budget funds;
- to the Ministry of Welfare:
 - to develop amendments to *the Law on the Insurance against Unemployment* improving the conditions of disbursement of unemployment benefits depending on the length of the insurance period;
 - to develop amendments to *the Social Services and Social Assistance Law* and the Cabinet Regulation “Regulations on the Recognition as Needy of a Family or a Person Living Separately”, providing that the disbursement of the guaranteed minimum income (GMI) benefit is stopped once the municipal social service finds that the social position of a family has improved and the average income per family member exceeds the income level of a needy family;
 - in cooperation with local governments, implement measures to improve the established control systems for administering the needy family status and the GMI benefit;

Annual Report 2010

- to the institutions of the Ministry of Health:
 - to develop a single remuneration system for the Emergency Medical Service that complies with *the Law on Remuneration of Officials and Employees of State and Self-government Authorities*;
 - to the State Limited Liability Company *Hospital of Traumatology and Orthopaedics*: to reach an agreement with medical institutions that have provided major joint endoprosthetic services regarding the takeover of the waiting lists for the service, and to develop internal regulations specifying procedures for the set-up, registration, and control of orthopaedic waiting lists;
- to the Ministry of Agriculture:
 - to assess the possibility of optimising the operations of scientific institutions and ensure that such reimbursement is set for scientific institutions that is based on clear basic principles, including criteria and principles that would justify the amount of the reimbursement specified for employees from various sources of funding, including an assessment of employee performance;
 - to develop suggestions for amendments to be made to *the Latvian Administrative Violations Code* to ensure that the State Forest Service is able to impose the penalty provided for in the Code – the confiscation of property (tools) – for violations for which it is authorised to impose an administrative penalty;
 - to initiate amendments to *the Law on Forests* to provide that confirmations for the felling of trees are only issued to persons who have paid off administrative penalties for violations of forest regulations and paid off the damages caused to forests;
 - to evaluate the proposal by the State Forest Service to impose a higher rate of immovable property tax on forest owners who have failed to undertake forest regeneration within the period prescribed by regulatory enactments;
 - to evaluate the environment protection requirements for the felling of trees in a forest regarding the planning of clear felling (concentration of clear felling areas), and in cooperation with environment protection NGOs to produce proposals for amendments to regulatory enactments that would eliminate potential risks of decreasing biodiversity and ensure the sustainability of natural resources;
 - to evaluate the need for immovable properties in ensuring the scientific operations of the Latvia University of Agriculture and its agencies; and for the University: to assess the possibility of optimisation of the agencies by integrating the agencies into its own structure;
- to the Ministry of Environment:
 - to ensure that a cooperation agreement is drawn up and concluded between the State Environmental Service and the Nature Conservation Agency, whereby the competencies of the bodies are set apart and the duplication of the functions of the State Environmental Service and the Nature Conservation Agency in specially protected nature territories is eliminated;

Annual Report 2010

- to develop a regulatory enactment that would authorise the State Environmental Service to adopt decisions regarding the valuation of confiscated fish and the transfer of revenues from the sale of illegally obtained fish into the State budget;
- to the Ministry of Economics and its institutions:
 - for the Ministry, as the authority responsible for the overall monitoring and coordination of building in the country, to initiate amendments to regulatory enactments to provide for types of structures, stages of construction of processes or structures that would be subject to mandatory inspections, in order to promote a single approach and principles in conducting inspections on sites by building inspectors. To improve the construction control system in order to exclude a situation where a building inspector has to evaluate the lawfulness of a construction process implemented by his employer – the local government – and where a local government is able to adopt more favourable decisions regarding violations in the construction process;
 - for the Public Utilities Commission to evaluate the need for amendments to the methodology or to develop another document binding on public service providers to ensure compliance with the requirements prescribed by the law and to assure that the Public Utilities Commission receive the draft tariff calculations altogether with the justification of tariff-forming costs. In developing the tariff calculation methodologies for public services (in the energy, household waste management and water management sectors), provide a clear explanation for the types of administrative costs and cost terminology included in the draft tariffs, specify the types of supporting documentation for costs, the level of detail of explanations to draft tariffs, and the basic principles of assignation of indirect administrative costs;
 - for the State Agency 'Investment and Development Agency of Latvia': to improve the internal control system to ensure the calculation and full collection of revenues due to the Agency for overdue lease payments for premises in accordance with the provisions of premise lease contracts;
 - for the Latvian Tourism Development Agency: to improve the internal control system to ensure compliance with the deadlines prescribed in the *Law on Value-Added Tax* for the issuance of invoices and the calculation and collection of revenues due to it from contractual penalties;
- to the Ministry of Transport and its institutions:
 - to develop a governance policy for the Road Traffic Safety Directorate specifying the financial and social objectives, operational results and performance indicators, and procedures for a regular review of the operations of the capital company;
 - in cooperation with the Ministry of Environment, initiate amendments to the regulatory enactment providing for the responsibility of a vehicle driver to properly store or dispose of vehicles not operated for an extended period, as well as procedures and a framework for the reduction of the number of vehicles registered on the Vehicle Register that have not been used for an extended period, thus promoting the safety of traffic participants and the reduction of environmental pollution;
 - to the Road Traffic Safety Directorate: recalculate the tariff of all services, setting a rate that corresponds to the cost of providing each service, thus

Annual Report 2010

facilitating the collection of a fee from clients that is appropriate to the cost of each service provided;

- to the Ministry of Justice and the State Land Service: assess the possibility of setting up a monitoring and information system that would ensure the notification of immovable property subjects and their involvement in the updating of the data in the information systems maintained by the Ministry of Justice: the Cadastre Information System, the State Register of Addresses, and the State Unified Computerised Land Register;
- to the Ministry of the Interior: in cooperation with the bodies directing proceedings, set up an information exchange system that would ensure the recovery of State funds used to store and sell arrested property.

The State Audit Office has notified law enforcement authorities regarding the squandering of State and municipal funds and property, failure to comply with regulatory enactments governing procurement, circumstances of conflict of interest, and other violations. In 2010, the State Audit Office forwarded a total of ten audit reports to law enforcement authorities, of those seven legality audit reports and three financial audit reports.

The audit materials of the State Audit Office were reviewed by competent authorities by means of various inspections and methods of criminal procedure.

In connection with the materials of State Audit Office audits forwarded to law enforcement authorities in the period between 30 May 2006 and 31 December 2010:

- 78 controls of various types have been initiated, of which four are still in progress. As a result of the completed controls, officials were held administratively liable in 13 cases; in 10 cases, the facts established by the State Audit Office were confirmed but no person was held liable due to a period of limitations; in one case, a prosecutorial response measure was imposed, and to the respective ministry a petition was forwarded regarding the suspension of the unlawful legislative acts issued by the local government, and the operation of the unlawful legislative acts issued by the local government was suspended at the prosecutor's request; a re-calculation of taxes payable into the budget was conducted; decisions were adopted to renounce the initiation of criminal proceedings; in the remaining cases, reprimands and verbal reproofs were issued; information has been received that control measures by competent authorities were scheduled or carried out, as well as information that the elimination of the violations found by the State Audit Office would be ensured;
- 44 criminal proceedings were initiated, of which 27 were terminated; in one case, the criminal proceeding was completed and the official was convicted and inflicted penalty; in five cases, the materials of State Audit Office audits were attached to criminal proceedings already initiated, of those one has been completed and the official has been convicted and inflicted penalty, whereas one proceeding has been terminated. A total of 19 criminal proceedings are at the investigative phase.

The State Audit Office constructively cooperates with the Office of the Prosecutor General and other law enforcement authorities and provides the necessary documents and information, as well as tracks the progression of the review of audit materials and the decisions adopted in the review process.

Annual Report 2010

Implemented audit recommendations is one of the most important indicators providing assessment of the work of the State Audit Office, which is why auditors oversee that the recommendations are implemented according to their substance.

In the reporting year, audited units had to implement 869 audit recommendations, of which 636, or 73%, were implemented; 196, or 23%, were at the implementation stage; and 37 recommendations, or 4%, were not implemented.

The most essential recommendations implemented by audited entities in the reporting year:

- in order to use funds as efficiently as possible in implementing its operational objectives and to earn maximum profit, Limited Liability Company Riga Eastern Clinical University Hospital of the Ministry of Health has terminated the contracts with the Limited Liability Company The Centre of Plastic and Reconstructive Microsurgery and the Limited Liability Company Wound Clinic regarding microsurgery services and services of bedsores treatment and has made a decision to conduct new procurement;
- the Ministry of Economics has taken steps to ensure efficient use of funds and recovery of funds used inappropriately:
 - it has ensured a more economical use of funds at the Limited Liability Company Latvian Guarantee Agency by reducing staff remuneration, lease payments for premises, and telecommunication expenses;
 - it has ensured that the Investment and Development Agency of Latvia and the Latvian Tourism Development Agency have improved the internal control system and collected both revenues due to them from delayed premise lease payments in accordance with the provisions of premise lease contracts, and revenues from contractual penalties;
- in order to achieve more efficient use of funds, the Ministry of Environment has:
 - commenced steps to ensure that inappropriately disbursed funds in the amount of LVL 8,765 have been recovered from the Joint-Stock Company BAO and transferred into the State budget;
 - ensured that the lease contracts regarding premises owned by the State in the person of the Ministry of Environment, concluded with State authorities do not stipulate charges that exceeds the cost of building maintenance, whereas contracts concluded with private individuals do not stipulate charges that are less than the cost of building maintenance;
- in order to ensure that only economically justified costs and costs associated with the provision of the service are included in the tariffs, the Public Utilities Commission has amended the methodology;
- in order to ensure additional State budget revenues, efficient use of funds, and improvement of the quality of the services provided, the Ministry of Transport has:
 - assessed the possibility of increasing the dividend payable into the State budget by the State Joint-Stock Company Latvian State Radio and Television Centre for the use of State capital, considering the amount of the Centre's retained profits in the preceding years and the funding

Annual Report 2010

- required for investment projects, as a result of which the State budget revenues from dividends have been increased by LVL 2.3 million;
- developed a regulatory enactment that facilitates the creation of an optimal network of regional intercity and regional local public transportation routes;
- having evaluated train and bus routes, the State Limited Liability Company Road Transport Administration closed bus routes that ran parallel to railways and modified, redistributed, or partially closed routes that were partially parallel to railways;
- in order to promote effective State administration work and to reduce the use of funds, the Ministry of Agriculture has
 - improved the criteria for the allocation of State assistance, eliminating the possibility of receiving support of the same type from European Union and State budget funds;
 - as a result of reorganisation, reduced the costs of the central administration of the Food and Veterinary Service and optimised the administrative expenses of the State Joint-Stock Company Rural Development Fund;
- to improve the internal control system of the Legal Aid Administration and to ensure regular control measures, the Ministry of Justice has developed the required regulatory enactments, improved the monitoring system to ensure the completeness of information in the Register of State-Ensured Legal Aid and the Register of State Compensations, and implemented measures to improve cooperation with sworn bailiffs;
- The Riga municipal Limited Liability Company Riga Transportation has improved the information technology environment and system functionality.

In order to ensure the achievement of the second long-term strategic objective – to ensure that **the audit themes of the State Audit Office correspond to public interest** – the following audit priorities have been set out in the Operational Strategy of the State Audit Office for 2010-2013:

- review of issues relevant to the general public or a social group;
- examination of complaints submitted by private individuals and institutions;
- evaluation of sectoral reforms implemented in the country;
- evaluation of the effectiveness and efficiency of the capital companies.

In accordance with audit priorities, taking into consideration the economic situation in the country, the government-implemented measures to consolidate expenditures, the increased public attention on certain issues, and the deficiencies detected during financial audits, the State Audit Office approved the themes of legality audits in March 2010.

In 2010, audit themes were related to the examination of such public-interest issues such as useful and efficient operation with State and municipal property and funds, the usefulness and quality of services provided to private individuals and institutions, supervision of the capital companies governance and the efficiency and usefulness of

Annual Report 2010

their operations; furthermore, residents complaints were considered when setting audit themes.

In the reporting year, the State Audit Office conducted audits on the following important issues:

- regarding the operation by various institutions with State budget funds and property, including cost efficiency and usefulness at institutions in the sports sector, in the operations of scientific entities in the agricultural sector, and in some local governments;
- regarding the activities of State and municipal authorities with respect to ensuring the fulfilment of obligations under the agreements with international financial bodies;
- regarding the effectiveness of governance and operations of capital companies and agencies in the health care, culture, and transport sectors;
- regarding the efficiency of operations of certain systems that have been set up, including the cost efficiency of the system of provisions of the National Armed Forces, the storage, sale, and disposal system of material evidence and arrested property, the system of compensation of losses caused to the environment, the *e-portfolio* implementation, and the system of administration of European Union funds.

Altogether, the State Audit Office completed 43 audits in 2010, including 26 financial audits and 17 legality audits, whereas the number of issued audit reports is 48, including 29 reports on financial audits and 19 reports on legality audits. The number of reports is greater than that of the audits, because multiple reports were produced for some audits.

Compared to the year before, the number of audits performed has decreased (there were 10 more legality audits in 2009), which can be explained by the reduction of financial resources in the recent years, which resulted in a decreased number of State Audit Office staff, including auditors.

Figure 2. Number of audits conducted and audit reports issued by the State Audit Office in 2010

	Financial audits	Legality audits	Total
Number of audits	26	17	43
Number of reports	29	19	48

In 2010, the State Audit Office continued to improve and update the audit methodology, thus ensuring the implementation of the third objective: to ensure that **audit methodology is consistent with best practice and international trends**.

The State Audit Office developed *Guidelines for the Application of International Standards on Auditing*, updated several work process descriptions: *Process of Conducting Legality and Performance Audits*, *Process of Auditing of the Economic Activity Report and Financial Statements of the Bank of Latvia*, *Process of Monitoring the Implementation of Audit Recommendations* and the *Process of Audit Quality Control*. The updating of the *Process of Conducting Financial Audits* has been completed, in which significant amendments were made, providing that the audit scope of the annual

Annual Report 2010

reports of ministries, central state institutions, and local governments is defined considering the risks identified in the annual report of the Republic of Latvia on the implementation of the State budget and budgets of local governments; audit manuals were also updated.

In 2010 the SAO continued implementing the latest version of the audit support tool, TeamMate, and upgrading the user manuals of all four software modules: Electronic Working Papers (EWP), Time and Expenses Capture (TEC), scheduling module (Schedule) and audit recommendations monitoring module (Central).

In the reporting year, the State Audit Office continued to use IDEA software for the analysis of large amount of data, and began using statistical samples in audits.

3.2. Ensuring the sustainability of development of the State Audit Office

Long-term strategic objectives

The following long-term strategic objectives have been set to ensure the sustainability of development of the State Audit Office: (1) highly qualified employees are provided for the State Audit Office; (2) the professionalism of the staff ensures audit work at a permanently high level; employees consistently engage in improving their professional knowledge; (3) resources are used efficiently; (4) an internal control system ensures transparent operations, high-quality monitoring and continuous improvement of operations at the State Audit Office; (5) staff members are engaged in international audit work and in working groups of international bodies; (6) staff members share their expertise, knowledge and professional support with other supreme audit institutions; (7) communication with audited entities, mass media and the Saeima facilitates an understanding of the outcomes of the State Audit Office work among the general public, politicians and the audited entities.

In order to recruit highly qualified employees who ensure the fulfilment of the first objective, the State Audit Office has improved the recruitment and selection process and the system of staff evaluation.

In 2010, the State Audit Office hired 21 new employees. In order to recruit highly qualified staff and to assess the knowledge of the candidates, examination tasks were developed for candidates applying for the position of State Auditor, and examination results were considered during the hiring of new auditors.

In accordance with the activities of the operational plan, individual tasks were approved for each employee, the execution of which was considered in evaluating employee performance. In the reporting year, qualification requirements of the positions were revised, and performance targets were specified in the individual tasks for each employee.

In 2010, 129 employees participated in the final performance evaluation; 95% of the employees got an assessment of A and B (A, the top assessment means that the requirements set for the position have been exceeded; B: compliance with the requirements set for the position) – which indicates a high level of professionalism among the staff.

To implement the second objective – **the professionalism of the staff ensures audit work at a consistently high level** – the State Audit Office continued to improve the

Annual Report 2010

quality of audit work, which included quality control of closed audits and quality promotion measures during audits.

As part of quality control of closed audits, the basic principles of sample formation and compliance with the audit methodology were examined during nine financial audits: in order to promote expertise sharing among audit departments, to identify instances of best practice and the necessary improvements to the audit methodology, and to gain assurance that audits are conducted in accordance with the procedures prescribed by the State Audit Office and the requirements of the International Standards on Auditing.

As a result of quality control of closed audits, best practice examples and necessary improvements to the methodology with respect to the selection of authorities to be included into the scope of the audit, the application of the statistical sampling method in detailed transaction inspections, the defining of criteria for the selection of transactions in case of non-statistical sampling, the calculation of a sample in case of a consolidated annual report, the determination of sample size and the scope of inspections to be performed, the determination of the impact of the errors detected on sample size and other issues.

During quality promotion measures, the employees in charge of audit methodology provided advice to auditors in the audit process. This served to ensure that audit reports comply with the State Audit Office methodology and provide clear and intelligible information.

It was ensured that the reports provide information on important issues at all ministries, other central government institutions and local governments, such as issues related to fiscal discipline; the "Remuneration" section of the report contained an evaluation of the compliance with the requirements of regulatory enactments of the allocation and use of funds that took place in 2009 from the budget sub-programme of the Ministry of Finance, "Funds for unforeseen events", and the compliance with Cabinet decisions regarding fiscal discipline and monitoring measures of the reallocation of funding among budget programmes and sub-programmes in 2009.

In order to **improve the professional knowledge of the staff**, thus ensuring the implementation of the third objective, training was provided to the employees.

In 2010, the employees attended 21 training events arranged by the State Audit Office – which included courses, seminars, experience sharing, and conferences – of which eight were conducted by external training service providers.

Similar to the year before, a number of experience sharing seminars took place in the reporting year covering issues relevant to audits, as well as new employee training, training and seminars on the use of the auditing tools (IDEA, TeamMate) used at the State Audit Office, and training sessions took place on the Public Procurement Law.

Seminars and conferences by outside training service providers were also organised for the staff of the State Audit Office on various topics, including quality management, accountancy issues, international standards on auditing, information systems, human resource management, legal issues, etc.

In 2010, the State Audit Office provided a total of 2,048 hours of training to its staff (in 2009: 1,929 hours). In 2010, one State Audit Office employee trained for an average of 13 hours (in 2009: 12 hours). The audit staff trained for 1,968 hours in the reporting year, i.e., an average of 16 hours per audit employee; whereas the support staff trained for 80 hours, or 2.1 hours per support employee.

Overall, a total of LVL 6,186 was spent on meeting training needs at the State Audit Office in 2010.

Annual Report 2010

In addition, State Audit Office employees regularly followed actual information on audit issues, including activities at the supreme audit institutions of other countries, and news in State administration; an employee spent an average of 15 hours on self-education in the reporting year.

In order to fulfil the third objective – to ensure that **resources have been used efficiently** – especially under budgetary constraints, the State Audit Office is devoting more and more attention to the efficient and useful use of funds.

In the reporting year, the financial resources of the State Audit Office have decreased by 19.1%, while maintenance expenses have decreased by 22.4% (see Annex 1).

In order to enable the administration of audit departments to track the workload of each employee and facilitate the planning process during the scheduling of audits, audits at the State Audit Office are scheduled using an audit support tool, TeamMate software. For the purpose of performing support functions, achievable results and activities to be conducted to implement them are scheduled in the operational plan, as are specific persons in charge, completion deadlines, man-hours and budget. As a result, the administration of the State Audit Office possesses full information regarding the cost of each audit, the achievement of the results of the operational strategy and the contribution of each structural unit in attaining the overall State Audit Office objectives.

In accordance with the audits and audit support activities approved in the annual working plan of the State Audit Office, employees enter data on the actual man-hours used up into the time capture system. Based on the data of the working time capture system, the State Audit Office structural units produce a quarterly report on the execution of the annual working plan of the State Audit Office, providing information on the implementation status of audit support activities, tasks accomplished in the particular period, and planned man-hours and budgets are compared with the actual implementation. The reports on the execution of the annual working plan of the State Audit Office from all State Audit Office structural units are analysed and compiled. The data thus obtained are used to assess the overall situation at the institution regarding the man-hours and budget funds used in evaluating the performance indicators of the State Audit Office, as well as for information purposes when scheduling activities for the next year.

In 2010, 84% of the overall working time was used on audits (scheduled: 75%), which indicates an increased intensity of audit work.

The implementation of the fourth objective – **transparent operations, high-quality monitoring and continuous improvement of operations at the State Audit Office are guaranteed** – was ensured by the internal audits and compliance reviews carried out by quality management system professionals.

In 2010, the internal control system of the State Audit Office was evaluated by conducting conjoint internal audits (see Annex 2). During the conjoint internal audits, a review of the internal control system of the State Audit Office was performed – as well as reviews of the quality management system. The rating of the internal control of each system subject to audit has been documented in the internal control evaluation and audit report of each audit. In order to improve the internal control system and the quality management system, recommendations were provided during the audits, which were agreed by the audited structural unit and the responsible person for the implementation of the recommendations and, approved by the Auditor General.

The results of the internal audits indicate that there exists an internal control system at the State Audit Office, which is operational, and is continuously improved.

Annual Report 2010

In the reporting year, the recommendations provided in internal audits were geared towards the improvement of internal regulations, as a result of which internal processes were optimised – towards the improvement of accountancy and personnel records system by eliminating deficiencies in system data or information; towards the improvement of the organisation of activities by individual structural units by promoting more efficient completion of tasks; towards the improvement of the control system by reducing various risks of irregularities; and the recommendations provided have facilitated savings of financial resources.

In order to implement the fifth objective – **improvement of international audit work through participation in joint audits and working groups of international audit bodies** – the State Audit Office took a very active part in international cooperation activities in the reporting year.

The aim of international cooperation is to present the achievements and successes of the State Audit Office to the international public, to strengthen the ability of the State Audit Office to perform public sector audits and to improve the professional competency of the staff. In order to achieve this, the State Audit Office is actively engaged in the international organizations of supreme audit institutions, INTOSAI and EUROSAI, it participates in international conferences and seminars, performs parallel audits and promotes bilateral and multilateral sharing of experience with the supreme audit institutions of other countries.

Cooperation with INTOSAI

INTOSAI is an independent international organisation of supreme audit institutions – the highest level of cooperation among external audit institutions – and its objective is to promote the sharing of experience amongst various national supreme audit institutions. The organisation has special consultative status with the Economic and Social Council of the United Nations (ECOSOC).

For more than fifty years now, INTOSAI has served as a forum for the strengthening of public sector auditing, the professional development of supreme audit institutions and mutual sharing of knowledge and best practice. INTOSAI currently unites 189 supreme audit institutions and four associated members, as well as the European Court of Auditors in the status of a supranational body.

In order to ensure the implementation of INTOSAI objectives, regional bodies of supreme audit institutions have been set up, regular meetings of permanent committees and working groups and other information events take place; also, a congress (INCOSAI) is held once every three years.

In November 2010, representatives of the State Audit Office participated in INCOSAI XX congress in Johannesburg, South Africa. With 152 member countries present, 44 official INTOSAI documents, developed as a result of the activities of the INTOSAI working groups over three years, were approved as part of the INCOSAI XX agenda: professional standards of INTOSAI (ISSAI) and Guidance for Good Governance in public sector financial management (INTOSAI GOV); and discussions were held on the following issues relevant to supreme audit institutions: the role and importance of supreme audit institutions and environmental audits and sustainable development. In the course of the congress, the results of the INTOSAI Strategic Plan for 2005-2010 were evaluated, and the INTOSAI Strategic Plan for 2011-2016 was ratified. The INTOSAI Strategic Plan for 2011-2016 provides for the implementation of six strategic priorities: to help ensure the independence of supreme audit institutions; promoting the implementation of INTOSAI's international framework of standards and guidelines (ISSAI); strengthening the capacity-building of supreme audit institutions; positioning of

Annual Report 2010

the role and importance of supreme audit institutions; strengthening the fight against corruption; and enhancement of INTOSAI communications.

In 2010, professionals from the State Audit Office continued their active participation in the INTOSAI working group on Key National Indicators by contributing to the drafting of the overall working group report to the INTOSAI Board, to the development of terminology for performance indicators, and to the production of draft guidelines for the use of performance indicators in the work of supreme audit institutions. In April 2010, during a meeting of the Working Group on Key National Indicators held in Astana, Kazakhstan, the Auditor General made a presentation on the introduction of international expertise on the use of national key indicators into audit activities.

In May 2010, representatives of the State Audit Office took part at the final meeting of the INTOSAI Working Group on the Audit of Privatisation, Economic Regulation and Public Private Partnerships in London.

In the course of the year, representatives of the State Audit Office continued their participation in the INTOSAI Working Group on Environmental Auditing, as well as on the INTOSAI Financial Audit Guidelines Subcommittee, where they evaluated a number of draft guidelines.

Cooperation with EUROSAI

EUROSAI is a regional body of INTOSAI uniting 49 European national supreme audit institutions and the European Court of Auditors. The objectives of the organisation are oriented towards the promotion of professional cooperation among European supreme audit institutions and other regional bodies of INTOSAI, exchange of information and documentation, promotion of research into public sector auditing, stimulating the establishment of academic positions in the sector and the standardisation of audit terminology. Similar to INTOSAI, EUROSAI also holds a congress every three years, as well as meetings of working groups, training events and seminars.

In 2010, employees of the State Audit Office continued their participation on the EUROSAI IT and Environmental Working Groups. Together with representatives from the Ministry of Finance and the State Revenue Service, State Audit Office professionals participated in a seminar organised by the EUROSAI IT Working Group on the application of new approaches to the prevention of value added tax fraud. Whereas by participating at the annual meeting of the Environmental Auditing Working Group in the Netherlands, State Audit Office professionals gained an insight into environmental audits conducted in other countries and improved their professional skills regarding renewable resource audits and the assessment of the impact of audits conducted in the environmental sector.

Active preparations took place in 2010 for the VIII EUROSAI Congress, which will be held in June 2011 in Lisbon, Portugal. State Audit Office staff members reviewed the draft documents developed by the working groups of the organisation, including the draft EUROSAI Strategic Plan for 2011-2017, and provided their comments and suggestions. Due to the proposed Congress theme, the member state opinion (working paper) of Latvia was prepared on the subject of the "Role of Supreme Audit Institutions in Promoting Accountability among State Administration Officials", as well as an article, "Supreme Audit Institution: A Guarantee of Transparency and Good Governance in a Democratic State", for publication in a brochure dedicated to the 20th anniversary of EUROSAI.

Cooperation with the European Court of Auditors

The European Court of Auditors (hereinafter: the Court) is the supreme audit institution of the European Union. The Court is the European Union's external audit institution, and it promotes better financial governance in the European Union and acts as an independent advocate of the financial interests of EU residents. The objective of its activities is to improve the financial management of European Union resources in order to ensure their optimal use in the interests of the public.

By inspecting the collection and use of European Union funds, the Court evaluates the manner in which EU institutions perform these functions. The court examines whether financial operations are recorded, whether they are carried out legally and appropriately, and managed in a way that ensures efficiency, effectiveness and productivity. The Court reports on its performance by publishing timely reviews, reports and opinions.

In 2010, the State Audit Office provided support for the implementation of thematic audit visits to Latvia, carried out as part of the following audits by the European Court of Auditors: audits related with the Declaration of Assurance for the financial year 2009 (DAS 2009) and expenditures in the areas of freedom, security and justice; financial audits of the European Agricultural Guarantee Fund (EAGF) related with the Declaration of Assurance for 2010; audits related with the Declaration of Assurance for the 2010 financial year (DAS 2010).

In November 2010, Dr. Igors Ludborzs, member of the European Court of Auditors, made a presentation to the State Audit Office staff regarding the Report on the Implementation of the European Union Budget in 2009.

Cooperation with the Supreme Audit Institutions of European Union Member States

Cooperation with the supreme audit institutions of the European Union Member States takes place mainly through the European Union Contact Committee and the working groups formed by it. The Contact Committee is an autonomous and independent association of the heads of the supreme audit institutions of the EU Member States and the President of the European Court of Auditors, which aim is to strengthen financial management and good governance in the European Union.

Meetings of the EU Contact Committee take place once a year. The issues to be addressed at a meeting are prepared by international liaison officers, who meet twice every year. In October 2010, the annual meeting of the EU Contact Committee, organised by the European Court of Auditors and the supreme audit institution of France, took place in Luxembourg. Its agenda included a seminar, "The Role of National Parliaments since the Lisbon Treaty Became Valid", as well as discussions on the scheduled changes in the European Union Financial Regulation, laying down the basic governing principles of the EU funds. According to the resolution passed during the Contact Committee Meeting, the State Audit Office of the Republic of Latvia will coordinate the implementation of the 2011-2012 activity "Exchange of experience on conducting audits of the governance of State-owned and municipal capital companies".

In February 2010, a representative of the State Audit Office participated in the plenary session of the Contact Committee's Working Group on Structural Funds IV in order to agree upon the structure and contents of the report of the parallel audit being implemented by the member states, "Cost Effectiveness and Compliance with Regulatory Enactments of the European Union Structural Funds Administration". A follow-up of the parallel audit was conducted in 2010, and a report on the audit results in Latvia, as member state, was forwarded to the coordinators of the working group, which will be included in the overall report of the working group.

Annual Report 2010

In 2010, representatives of the State Audit Office continued their participation in the EU Contact Committee's Working Group on Value Added Tax and were involved in the information exchange networks formed within the framework of the Contact Committee on the national report on the management of EU financial resources and on the Lisbon Strategy/Europe 2020 audits. In August 2010, a representative of the State Audit Office participated in a seminar on auditing issues regarding the Lisbon Strategy and the Europe 2020 strategy, organised by the European Court of Auditors, thus obtaining additional information about the results of the implementation of the Lisbon Strategy and the objectives and implementation tools of the Europe 2020 strategy, as well as insight into the experience of the supreme audit institutions of the European Union member states with conducting such audits and their future plans in this respect.

Cooperation between the Baltic and Nordic supreme audit institutions

On 9 and 10 September 2010, Riga hosted the annual expert-level meeting of the Baltic and Nordic supreme audit institutions, with the participation of representatives from eight countries: Denmark, Estonia, Latvia, Lithuania, Norway, Poland, Finland and Sweden. In the course of the meeting, professionals of specific auditing areas shared knowledge on the latest developments and trends associated with the following themes, closely related with the conducting of audits: the impact of the economic recession on the selection of separate audit themes and on the audit planning process as a whole; auditing approaches in the implementation of audits of state-owned and municipal capital companies; experience of the supreme audit institutions with the application of data processing systems in the implementation of legality and performance audits/application of quantitative audit methods in the implementation of performance audits.

The next meeting of the Baltic and Nordic supreme audit institutions at the level of institution heads will take place in late August 2011 in Oslo, Norway.

Towards the fulfilment of the sixth objective – **to share expertise, knowledge and provide professional support to other supreme audit institutions** – in the reporting year, the State Audit Office engaged in very active bilateral cooperation with the supreme audit institutions of other countries: by organising training events and providing practical assistance in audit activities. The State Audit Office has become well known among its colleagues, and a number of supreme audit institutions wish to cooperate with Latvian auditors and other our professionals.

In 2010, agreements were reached and understanding memoranda were signed between the State Audit Office and the Chamber of Control of Georgia and the Control Chamber of the Republic of Armenia. These agreements provide for the sharing of experience in order to improve the audit methodology, professional training and the professional development of staff, exchange with informative material and documents, and arranging of joint projects and audits.

As part of the memorandum of mutual understanding, concluded with the State Control Committee of the Republic of Belarus, officials of the State Audit Office made an official return visit to Minsk, Belarus, in May 2010. The visit included a meeting with the Chair of the Belarusian State Control Committee and other top state officials of Belarus. In 2010, the State Audit Office professionals provided advice to their Belarusian colleagues regarding the application of the possibilities afforded by the IDEA software in audit work. An exchange of experience seminar is scheduled for the second half of 2011.

As part of the bilateral cooperation between the State Audit Office and the Chamber of Control of Georgia, a cooperation agreement was signed in August 2010 regarding the implementation of a training project. The project aims to improve the practical auditing

Annual Report 2010

skills of the auditors of the Chamber of Control of Georgia. In the course of the project, State Audit Office professionals supply advice and provide support in conducting pilot audits, covering all stages of conducting of an audit.

In 2010, the State Audit Office and the Account Chamber of the Kyrgyz Republic continued the joint implementation of a project funded by a grant from the Institutional Development Fund to build capacity in public sector auditing. Project implementation is scheduled to be completed by May 2011. Project activities include training of auditors of the Account Chamber of the Kyrgyz Republic, improvement of the auditing methodology to meet the requirements of international auditing standards, and validation of the methodology developed in pilot audits. In 2010, the project component related to the development of an auditing methodology consistent with international auditing standards was completed, during which State Audit Office professionals provided training and advice on issues regarding the development of a financial auditing methodology to representatives of the Account Chamber of Kyrgyzstan.

The State Audit Office has developed a successful partnership with the Accounts Chamber of the Russian Federation. In the course of this partnership, in 2010 the planning of the fourth parallel audit run jointly by the two institutions was started. The audit proposes to evaluate the actions of the responsible institutions in implementing the international agreements entered into.

In September 2010, Auditor General Inguna Sudraba visited Yerevan, Armenia, in order to participate in the annual meeting of the heads of the supreme audit institutions of the Commonwealth of Independent States, thus expanding bilateral cooperation and acquiring new professional experience and view on the basic regulations of the other states supreme audit institutions work.

In order to **improve communication and cooperation with audited entities, the general public, mass media and the Saeima**, thus implementing the seventh objective, the State Audit Office cooperated with mass media, the Auditor General took part in various conferences, discussions and forums, met with officials and worked with the Public Expenditure and Audit Committee of the Saeima, other parliamentary committees, and the Cabinet of Ministers.

Cooperation with mass media

In 2010, the State Audit Office continued to improve its cooperation with mass media by distributing press releases and through individual interviews given by the Auditor General on the radio, television and in the press. The Auditor General has provided information on the results of audits, including to foreign journalists who have shown interest in the results of certain audits. Unmediated and regular provision of information to the general public has facilitated both the achievement of the State Audit Office's objectives and a greater public awareness of the way in which institutions operate with State and municipal funds and property.

In the reporting year, the State Audit Office strengthened its cooperation with certain journalists within each medium, specialising in issues of state administration and finance, as well as provided focused clarification of the specific character of the audit work performed by the State Audit Office and the importance and context of the audit results, thus promoting greater explicitness of the information available from the mass media – and it has often inspired further analytical discussions on the auditors' findings.

In 2010, the Auditor General made a number of interviews on television and the radio, providing explanations on the State Audit Office audit findings and expressing opinions on socio-political and economic issues that are of importance to the public.

Annual Report 2010

In 2010, more than 150 publications have appeared in the central and regional press regarding audit results disclosed during 2010 (in the newspapers *Diena*, *Neatkarīga Rita Avīze Latvijai*, *Latvijas Vestnesis*, *Latvijas Avīze*, *Dienas Bizness*, *Rīgas Aprīnka Avīze*, *Телеграф*, *Вести Сегодня*, *Бизнес&Балтия*, *Час*, the magazine *Gramatvedība un Ekonomika* etc.).

The most important interviews and press publications in 2010 concerned audit results in the public utilities sector, the use of State funds in hospitals, the actions of the State Agency *The New Three Brothers*, the administration of the State funds allocated to sports, audits of annual reports of the government ministries and other issues relevant to the public.

Participation of the Auditor General in conferences, discussions and professional forums

To promote the awareness of various representatives of the general public and professionals from various sectors, and to enhance feedback by learning the opinions of professionals and members of the public, the Auditor General participated in various conferences, meetings, seminars and discussions in 2010. This helped to strengthen the links between the State Audit Office and field professionals and the public, and enabled a much broader and more complete exchange of important information.

In 2010, the Auditor General participated at a meeting of chief prosecutors at the Office of the Prosecutor General; the conference dedicated to the 20th anniversary of the Office of the Prosecutor of the Republic of Latvia; a board meeting of the Free Trade Union Confederation of Latvia; a discussion organised by the Strategic Analysis Commission of the President's Chancery, "Definition of the status of political parties and direct democracy as solutions to the crisis of the Latvian political system"; the annual teachers' conference, "People of Latvia in educational space and time"; the Baltic Economic Forum; and a number of other events.

The State Audit Office has responded to a number of invitations to present to student audiences, and the Auditor General gave an address at the seminar "Let us not sell out Latvia!" at the University of Latvia, took part in a conference organised by the Riga International School of Economics and Business Administration and presented a public lecture at the Vidzeme University of Applied Sciences.

Following some public addresses by the Auditor General – such as after the Baltic Economic Forum, – extensive exchange of opinions arose among the public. Such discussions greatly promote the formation of understanding among members of the public regarding the ways in which taxpayer money should be spent and the type of environment in which State administration should operate.

Key meetings of the Auditor General with state officials of the Republic of Latvia

In 2010, the Auditor General, Inguna Sudraba, had numerous meetings with Latvian State and municipal officials of various rank to discuss the results of audits conducted by the State Audit Office.

The reporting year has highlighted the role of the State Audit Office as an expert in characterising the economic issues of our country, as Auditor General Inguna Sudraba has met with representatives of the World Bank mission and the International Monetary Fund on multiple occasions to explain the features of the national financial system and administration and to inform on the findings of the State Audit Office in the audit on the use of the World Bank loan in the social sector.

Cooperation with the Saeima, the Public Expenditures and Audit Committee of the Saeima, other parliamentary committees and the Cabinet of Ministers

During the reporting year, the State Audit Office maintained active cooperation with the Saeima – which did not include only reporting on audit activities, but also active involvement in the improvement of the State financial system by proposing amendments to regulatory enactments.

Both in its audit work and in its participation in the work of the Public Expenditure and Audit Committee of the Saeima, the State Audit Office concluded that regulatory enactments contain significant deficiencies and that the policy and budget formation process does not allow for an assessment whether State budget funds have been used in an efficient and effective way, which is why enactments must be improved. The State Audit Office developed specific amendments to *the Law on Budget and Financial Management* and *the Development Planning System Law*. These proposals provide for a fundamental change in the current policy and State budget formation process and prescribe that State policies and achievable results are approved first, and resources are then planned in accordance with them; strict accountability for accomplishments is also provided for. The initiative by the State Audit Office gained support in the Saeima of the previous convocation, and a working group was set up under the leadership of the Chair of the 9th Saeima for its progression.

The State Audit Office informed the President, the Public Expenditure and Audit Committee of the Saeima, other responsible parliamentary committees, the Prime Minister, the Minister of Finance and other government ministers regarding the reports of the top-priority audits and the violations detected during the audits.

In 2010, the Auditor General and other responsible State Audit Office staff participated in the meetings of the Public Expenditure and Audit Committee of the Saeima, during which reports on 19 audits conducted in the reporting year were reviewed and the violations detected were discussed; furthermore, jointly with ministries and other central government institutions, they participated in meetings in which the progress of the implementation of the recommendations issued by the State Audit Office to audited entities was examined.

The State Audit Office notified the Public Expenditure and Audit Committee of the Saeima and other responsible parliamentary committees on the 2009 report of the Republic of Latvia on the implementation of the State budget and budgets of local governments; the administration of State budget funds allocated to sports; the compliance of the actions of the State Agency *The New Three Brothers* with the provisions of regulatory enactments; technical provision of the National Armed Forces; the accessibility of the services of the State Land Service; the efficiency and effectiveness of the costs at the Hospital of Traumatology and Orthopaedics; the World Bank loan to implement a social safety net and reforms of the social sector; the operations of the scientific institutions of the Ministry of Agriculture; the compensation of losses caused to the environment; assessment of the operations of the Road Traffic Safety Directorate; the effectiveness of the electronic payment system introduced by *LLC Rigas satiksme*; the effectiveness of the system of administration of the European Union structural funds; etc.

After the audit reports were submitted, the Public Expenditure and Audit Committee of the Saeima obligated the ministries and other central government institutions to report on the implementation of the recommendations issued after the audits.

The State Audit Office also informed the President and the Prime Minister of the key audit reports.

In the reporting year, the State Audit Office became actively involved in the work of the Public Expenditure and Audit Committee of the Saeima as part of its function to monitor the programme of Latvian economic stabilisation and growth restoration. The Committee has approved a working plan, according to which a time table, the themes for examination, the responsible institutions and the information to be submitted to the Committee has been set up. The State Audit Office provides support to the Public Expenditure and Audit Committee of the Saeima by evaluating the draft documents developed by the responsible institutions and other information and by developing materials and information summaries to be reviewed at the Committee meetings.

4. Results of the State Audit Office Audits

4.1. Legality audits

When conducting the legality audits, auditors examine the compliance of the transactions and activities by the audited entities with regulatory enactments and the planned results; in addition, the efficiency, effectiveness and productiveness of the work of the audited entities are examined during audits.

In 2010, State Audit Office auditors completed 17 legality audits. During these audits, auditors assessed the effectiveness of the operations with budget funds and property by State and municipal authorities, the implementation of certain systems in accordance with their established objectives, the efficiency of the operations of some State and municipal capital companies, the efficiency of the administration of European Union funds, as well as the accessibility of services at various State institutions. The State Audit Office also paid attention to the measures planned to fulfil certain objectives of international financial loans and the efficiency of the use of financial resources.

In the audits, the State Audit Office found that, at many institutions funded from the State budget, resources are still being used inefficiently and unproductively, accounting of the State budget funds are not transparent and losses have been incurred to the State budget; the audited State capital companies and agencies have not ensured effective procedures to control the use of financial resources and the public procurement processes, certain systems have been set up inefficiently, and some local governments have operated with financial resources and property in an inefficient and unlawful way.

A brief description of concrete audits conducted in 2010 is given below.

Audit “The Economy, Effectiveness and Efficiency of the Direct and Indirect (General) Costs, Including Administrative Costs, of the State Limited Liability Company Hospital of Traumatology and Orthopaedics”

Audit objective was to examine the effectiveness, usefulness and legality of the direct and indirect (general) costs, including administrative costs, of the State Limited Liability Company Hospital of Traumatology and Orthopaedics (HTO).

The State Audit Office disclosed during the audit that the HTO orthopaedics queue data do not correspond to the actual data, e.g. it has been disclosed during the audit that patients had been registered in the orthopaedics queue after surgery, or that a patient had actually undergone state-funded surgery under the urgency procedure while in the registration of the orthopaedics queue the same patient had been registered in the 50% co-funding queue.

Annual Report 2010

Furthermore, the HTO has not provided reliable information regarding the number of patients accepted into the queue and the number of patients excluded from the queue, e.g. according to the hospital's records, as of 31.12.2009. the number of patients in the queue for planned endoprosthesis of the knee joint under the urgency procedure was 555 patients, but the report submitted to the Health Payment Centre HTO indicated a number that was smaller by 187 patients.

The SAO disclosed that in the procurement of endoprostheses and receipt of services for the total amount of LVL 856 666 the HTO had not complied with the requirements of the Public Procurement Law, among others, and did not conduct procurement procedures and therefore it is possible that the most advantageous proposals had not been chosen, thus causing a risk of uneconomical and inefficient utilisation of the state budget funds.

For instance, the HTO purchased 50% (equal to LVL 701 249) of the big joint endoprostheses used at the hospital through an agreement on the prices of endoprostheses with the suppliers rather than conducting a public procurement. Furthermore, the HTO paid LVL 53 426 (without VAT) to a company for examination and technical maintenance of medical devices and equipment without surveying cheaper and more advantageous proposals.

The HTO does not ensure internal control over the process of public procurement and does not provide sufficient monitoring of the performance of procurement contracts. The SAO disclosed that, contrary to the provisions of the Public Procurement Law, the scope of the subject of the contract and the contract price are not indicated in the procurement contracts.

Audit "Economy, Effectiveness and Efficiency of Direct and Indirect (General), Including Administrative Costs of the Limited Liability Company Liepaja Regional Hospital"

Audit objective was to examine the effectiveness, efficiency, compliance with activity objectives and lawfulness of direct and indirect (general) costs, including administrative costs, of the Limited Liability Company Liepaja Regional Hospital.

The State Audit Office disclosed during the audit that Liepaja Regional Hospital should introduce effective control procedures over the use of financial resources and over the process of public procurement.

Non-observance of public procurement procedures and lack of internal control over these procedures has resulted in a risk of uneconomical, ineffective and inefficient use of resources in the amount of LVL 145 116.

During the audited period the Hospital deliberately evaded implementation of procurement procedures specified by the law, entering into purchase contracts, which stipulate estimated total yearly contract price of LVL 3000 (excluding VAT), however on average within a period of one month disbursing LVL 3 685 and LVL 8 800 for delivery of goods to two suppliers.

The Hospital has conducted purchase of goods on the basis of contracts that are not in force, as well as has purchased goods not entering into contract with the winning tenderer. The contracts do not indicate implementation timelines, volumes of the procured goods and the contract price. In the time period of validity of the contracts

Annual Report 2010

entered into total price volumes of goods purchased by the Hospital exceed the total determined contract prices.

In the audit SAO did not obtain assurance on accounting of deposited goods and completeness of stocks and liabilities indicated in the annual report for 2009 of the Hospital, as the amount of liabilities to suppliers, who deposited goods for the keeping at the Hospital, does not comply with the requirements of the contracts entered into.

The Hospital has ineffectively and inefficiently utilised resources in the amount of LVL 34 084, covering the costs of residential premises for attracted medical personnel with average area of 75 m² per person, located in the centre of the city in renovated buildings, including with a sea view, although there are apartments available in the public sector of Liepaja suburbs at up to two times lower price.

In 2009 the Hospital has uneconomically utilised LVL 13 028, maintaining motor vehicles transferred for use to members of the board, as the destination of only 33% of trips was related to implementation of work duties. Kilometres indicated in the waybills do not comply with the indicated routes. There were also occasions disclosed, when simultaneously several vehicles are engaged in one day on the same route.

Audit “Activity of the State and Local Government Institutions Ensuring Fulfilment of Obligations under the Agreement between the Republic of Latvia and the World Bank “Loan for Implementation of Social Security Network and Social Sector Reform” and the World Bank Programme Document”

Audit objective was to gain assurance that the responsible State and municipal authorities have undertaken the measures specified in the Program Document approved by the International Bank for Reconstruction and Development (the World Bank) (Programme Document) and ensured that the prescribed performance indicators are attained.

The State Audit Office disclosed in the audit that half a million lats were used without substantiation when implementing the social security network measures.

Auditors concluded, that it is necessary to adjust internal control procedures of local government social service institutions, as well as to improve regulatory enactments with the aim to prevent such situations, when the status of a family in need is also granted to families owning several immovable properties or motor vehicles or when income per each family member exceeds the level of income of a family in need. Thus, for example, the status of a family in need was granted to a family owning nine motor vehicles, two of which were purchased during the period, when the status of a family in need was granted, or a family was recognised as a family in need, although there are six motor vehicles and four immovable properties in the ownership of the family. 73% of these families were granted the benefit for ensuring the guaranteed minimum income level without substantiation – all together in the amount of LVL 116 371.75. The status of a family in need grants the right of receiving immovable property tax relief or healthcare services and medicinal products intended to be compensated.

Likewise, to ensure rational utilisation of the State social insurance special budget funds and the sustainability of the special budget, SAO invites the Ministry of Welfare to review the procedure for calculating the unemployment benefit to persons with the length of insurance from one to 19 years, whose initially calculated unemployment benefit is less than LVL 45. Until the end of 2011 during the last benefit disbursement months these

Annual Report 2010

persons are receiving the benefit in the amount of LVL 45 not taking into account the amount of social insurance contributions. This procedure for calculating the unemployment benefit does not comply to the basic principles of the State social insurance, as well as the equality principle stipulated in the Constitution, as persons with the length of insurance above 20 years during the entire period of disbursement of benefit are receiving thereof only in accordance with the contributions made, not guaranteeing minimum amount of LVL 45. LVL 342 088 were utilised for disbursement of the unemployed benefits to these persons without substantiation.

Implementing the measure “*Work Practice at Local Governments, Receiving a Grant*”, the State Employment Agency and local governments have not ensured establishment of work practice positions, involvement of persons and purchase of inventory in accordance with the Cabinet Regulation and the objective of the measure. Thus, for example, also such unemployed persons are being involved in the programme, who are receiving the unemployment benefit or who have refused the unemployment benefit, or who have been employed at the same institution, where work practicing has been organised. Such inventory has been purchased within the framework of the measure, which is not related to responsibilities under respective work measures.

The State Audit Office also indicates that there is no information aggregated on references issued by local government social service institutions, which grant the right of receiving relief from patient payment and patient co-payment or receiving medicinal products intended to be compensated without patient co-payment. Therefore the Ministry of Health does not have impartial information on the number of potential service recipients and service rendering term, when planning financing necessary for implementation of health measures.

Audit “On Compliance of the Action of the Ministry of Culture and the State Agency “The New Three Brothers” with the Requirements of Regulatory Enactments, Ensuring Design, Construction and Financing of the State Culture Objects”

Audit objective was to obtain assurance on the compliance of the actions of the Ministry of Culture and the State Agency *The New Three Brothers* with the requirements of regulatory enactments, ensuring the designing, construction and financing of State cultural objects.

The State Audit disclosed in the audit that the Ministry of Culture and the State Agency “The New Three Brothers”, implementing design, construction and financing of the State culture objects, have not ensured effective use of the State budget funds.

It was disclosed that objectives of large investment projects are not clearly stipulated in the policy planning documents. The priority objectives and action directions with regard to construction of culture objects of National importance were determined only in 2006, after commencement of implementation of projects – the National Library of Latvia (NLL), the acoustic Concert Hall and the Museum of Contemporary Art. As a result of which the public gain does not correspond to the amount of utilised resources.

Thus, for example, almost four million lats were utilised for implementation of the acoustic Concert Hall project, however, the only result is approved sketch project, in turn from the allocated State budget financing for implementation of Museum of Contemporary Art project LVL 74 340 has been utilised for the purposes not related to objectives of the project implementation. Entering into agreement with the LLC

Annual Report 2010

“*Jaunrigas attistibas uzņemums*”, the Agency violated the rights of representation and created legal and financial risks at least in the amount of LVL 526 912. Moreover, the Ministry did not take any action to eliminate the illegal activity of the Agency.

Also, from the State budget financing, allocated for implementation of NLL project, at least LVL 209 386 were utilised for the purposes not related to objectives of the project. Besides, the Construction Contract entered into by the Agency on LVL 135.3 million does not ensure construction of NLL at the possibly lowest cost. The contract was entered into, regardless of the expert's opinion that the tenders, total amount of which exceeds LVL 116.5 million, are valued as economically disadvantageous. In turn, opinion of professional organisations of Latvia construction sector that the tendered construction works cost is substantiated and corresponds to the market situation, was taken into consideration, although such opinion lacked substantiation of an expert-examination.

Payment provisions for the works implemented and accounting thereof specified in the contract entered into between the Ministry and the National Association of Construction Companies (NACC) may be interpreted differently, thus there is a risk that the savings, which have occurred due to deflation of construction costs and the reduced volume of construction works, will be utilised to settle the claims of NACC for additional works at least in the amount of LVL 2.4 million.

Auditors consider that the Agency has acted uneconomically disbursing second advance payment to NACC in the amount of LVL 8.0 million, regardless of the fact that previously disbursed advance payment in the amount of LVL 5.0 million was at the disposal of NACC. Besides it happened during the time, when it was necessary to ensure rational and economical utilisation of the State budget funds.

Although the Cabinet assigned the Ministry in cooperation with the State Property Fund and Riga City Council to perform the necessary activities for taking over the land plots necessary for construction of NLL into ownership of the State, the State budget incurred additional costs at least in the amount of LVL 2.4 million, as the responsible authorities could not reach an agreement on the necessary amendments to regulatory enactments, in order to solve the issue on allocating other place of residence of equal value to tenants and their families.

There is a risk that the costs of NLL project has been increased, while planning the area of premises for ensuring operation of NLL. Number of foreseen reader places within NLL building design is not based on research and in accordance with calculations done by SAO the number of readers is 4.5 times larger compared to the number at existing reading rooms of NLL. 5.1% or 2 093m² from the total area of NLL is foreseen for public premises, where public events will be held, and it is planned to obtain yearly revenue in the amount of LVL 0.48 million utilising the premises for this purpose. It is planned to locate the infrastructure necessary for ensuring operation of NLL outside the new NLL building, performing additional designing and construction works.

Also planning of the financing for NLL project is incomplete, as the financing foreseen in the State budget for implementation of the project is by LVL 73.27 million less than necessary. To complete implementation of NLL project LVL 192.16 million are necessary starting from 1 January 2010. Besides, implementation of NLL project was commenced taking into account co-financing of Riga City Council, although such agreement has not been reached with Riga City Council.

Annual Report 2010

Audit “Accessibility, Quality and Compliance with the Requirements of the Regulatory Enactments of Services Rendered by the State Land Service”

Audit objective was to obtain assurance that the services rendered by the State Land Service (the SLS) are accessible, of high quality and rendering thereof complies with the requirements of the regulatory enactments.

It was disclosed in the audit that data of the information system of the State Cadastre of Immovable Property (Cadastre information system) do not correspond to the actual condition of immovable property.

As data control and supervision mechanisms of the Cadastre information system have not been introduced, compliance of data to the actual condition of immovable property is not ensured.

At present topicality of the data registered in the Cadastre information system maintained by the SLS and compliance thereof with the actual condition of immovable property depends on the subject of immovable property, as well as on decency of the State and local government institutions observing responsibilities specified in the regulatory enactments, as the regulatory enactments developed by the Ministry of Justice (the Ministry) do not specify an institution responsible for accuracy of the registered data. The regulatory enactments also do not specify provision of single supervision, cooperation and control system to ensure topicality of data in the Cadastre information system maintained by SLS.

Consequently, erroneous, incomplete or different data are entered into the Cadastre information system, thus there is a risk that, for example, cadastral values of apartment properties and immovable property tax is not calculated accurately.

SAO disclosed in the audit that data indicated in the Cadastre information system regarding an owner of immovable property, as well as regarding undivided shares does not comply with the data indicated in the State Unified Computerised Land Register (SUCLR). In turn, on specific occasion the cadastral value indicated in the Cadastre information system calculated for similar apartment properties varies. For example, cadastral value of apartment properties on 417 Maskavas Street, Riga with the total area of 50.2 m² to 50.4 m² ranges from LVL 1754 to LVL 17 437, which varies up to 10 times.

Due to improperly arranged information system, authorised users of the portal www.kadastrs.lv do not have access to quality information that complies with the requirements of regulatory enactments in the amount of 26% from the number of randomly inspected immovable properties.

By not ensuring protection of data transferred to SUCLR towards access of third persons and data editing, as well as not ensuring control of completeness of data sent by SUCLR and received and processed by SLS, the Ministry's data exchange mechanism between SUCLR and the Cadastre information system is incomplete.

Audit “Compliance of Administration of the State Budget Funds for Sports with the Requirements of Regulatory Enactments at the Ministry of Education and Science”

Audit objective was to obtain assurance on compliance of administration of the State budget funds for sports with the requirements of the regulatory enactments at the Ministry of Education and Science.

It was disclosed in the audit that the Ministry of Education and Science (the Ministry) does not ensure that the resources allocated from the State budget funds for sports are used effectively and transparently.

The Ministry does not ensure transparent administration of the resources allocated for sports, and it has not developed such regulatory framework for financing of the sports sector, which would ensure systematic and oriented at achievement of the objective operation of the system, as well as has not developed unified procedure by which the State budget funds for sports shall be allocated that would ensure control over utilisation of resources.

Auditors disclosed that the audited organisations, which administer the State budget funds for sports allocated by the Ministry, over the period of one and a half year for administration expenditure have utilised LVL 2.1 million or almost one fifth (18%) of the allocated financing, in turn the Association “Latvian Olympic Committee” (LOC) and Association “Council of the Latvian Sports Federations” (CLSF), the Limited Liability Company “Latvian Olympic Team” (LOT) and the State Agency “National Olympics Sports Methodological Centre” for financing of sports federations and implementation of sports events in 2008 and 2009 have utilised 35% of all allocated State budget funds.

Although the Ministry does not have legal grounds for doing so, the Ministry allocates the State budget financing for further distribution and involves LOC and CLSF in controlling the utilisation thereof. Besides, although the Ministry is allocating resources for implementation of LOC programmes, which amounted up to LVL 6 million in 2008 and LVL 5 million in 2009, the Ministry does not have at its disposal the implemented programme and information on expenditure included therein and final beneficiaries.

The Ministry has not determined principles for work remuneration financed from the State budget and the maximum amount of work remuneration at sports organisations. Thus work remuneration of LOC, CLSF and LOT employees in 2009 has significantly exceeded, sometimes even two or three times, the average work remuneration both in private and public sectors.

The State budget funds that were allocated for organisation of international sports events in Latvia, which are placed by organiser of an event as security deposit at international organisations and after specific period of time – recovered, are not returned to the State budget at least in the amount of LVL 540 000.

Sports organisations have delegated organisation of events specified in the cooperation contracts to foundations, thus increasing the costs of these events. For example, organisation of *Euro Basket Women 2009* was not ensured by the Association “Latvian Basketball Association”, but by the foundation established by the Association, utilising LVL 45 843 for administrative costs.

Implementation of the recommendations of the Closed Legality Audit “Cost Effectiveness and Compliance with Legal Enactments of the European Union Structural Funds Administration”

Audit objective was to gain assurance regarding the implementation of the recommendations included in the Closed Legality Audit “Cost Effectiveness and Compliance with Legal Enactments of the European Union Structural Funds Administration” and the sufficiency of the measures undertaken to eliminate the deficiencies.

The audit was conducted as part of the parallel audit on the costs of controls of the European Union structural funds, which is coordinated by the Working Group on Structural Funds IV of the Contact Committee. The scope of the audit and the issues to be covered by the audit has been adapted to the issues covered by the Parallel Audit.

It was disclosed in the audit that in implementing audit recommendations the Ministry of Finance has improved the regulation for the recovering and monitoring of the inappropriate utilized funds, but still has not eliminated a part of significant deficiencies in the system for supervision over the European Union Funds Implementation.

The system for supervision over the utilisation of the European Union Funds does not provide assurance on systemic approach for controlling and analyzing the use of EU financial resources. Management of the EU Funds is oriented more towards using funding rather than effective utilization and introduction of more justified activities that is argued by disclosed deficiencies in the planning and distribution of the EU Funds activities.

Ministry of Finance do not provide good quality EU Funds management to stabilize macro economical situation in the country, because appropriate evaluation of the EU Funds contribution impact was not realized. EU Funds management system needs to be improved by introducing measureable indicators, performing results evaluation and supervising the achievement of the set objectives, if the stabilization and sustainable development of the economy should to be reached by using the EU Funds activities.

In order to reduce the costs associated with the administration and control of the European Union funds and to create a system in which the checks of supporting documents for expenses would be carried out as efficiently as possible, amendments are required to regulatory enactments. It is still the case that, when performing checks on applications for payments, the authorities examine the supporting documents for expenses to the full extent rather than selectively. Thus, the Ministry of Finance has not ensured a sufficiently effective and efficient use of LVL 2.7 million, as multiple authorities duplicate the steps, and a burden and unnecessary expenses are created for the beneficiary as they copy and forward to the relevant agencies all the supporting documents for expenses.

Audit “Efficiency of Introducing Electronic Payment System in the Public Transport by Riga Municipality LLC “*Rigas satiksme*” and Compliance Thereof with the Requirements of Regulatory Enactments”

Audit objective was to obtain assurance that the Riga City LLC *Rigas satiksme* (*Rigas satiksme*) has observed the requirements of regulatory enactments during the process of introducing an electronic payment system in the Riga public transport; to establish whether the actions of *Rigas satiksme* with financial resources when introducing an electronic payment system in the Riga public transport has been efficient.

Annual Report 2010

It was established during the audit that, in introducing the electronic payment system, *Rigas satiksme* failed to consider the convenience and finances of the residents of Riga.

Although electronic payment system in Riga public transport (e-ticket) does not have substantial advantages compared to the previous ticket punch payment system, use and maintenance thereof over the period of 13 years will cost at least by LVL 100 million more.

Regardless of substantial cost increase, Riga Municipality LLC "*Rigas satiksme*" before taking the decision on establishment of joint venture with Affiliated Computer Services Solutions France S.A.S, establishing the Limited Liability Company "*Rigas karte*" (LLC Riga Map) for introducing electronic payment system, has not determined achievable results and has not assessed substantiation of increasing costs in relation to advantages of public transport users and the provider of the service.

Rigas satiksme, not using the rights specified in the regulation of negotiated procedure for selection of candidates to request additional information on specific cost positions of the offers, which were comparable, has entered into contract with the winner, the submitted costs of which were by LVL 1 million higher than offered by other candidates.

Although Riga Traffic had the right to attract available resources from EU funds within the planning period 2007-2013, the capital company did not do so.

Auditors considers that the selected introduction model of e-ticket via establishing a joint venture creates a risk that costs of public transport services and tariffs will increase without economic substantiation, as well as additional Riga tax payers' resources will be necessary for compensations to transport carriers.

Riga Traffic without economic substantiation has undertaken to pay over the period of 13 years for maintenance of electronic payment system up to LVL 16 million more than the business partner has undertaken to carry out according to the offer. Maintenance of electronic payment system via joint venture over the period of 13 years will cost to Riga Traffic up to LVL 7.4 million more than supporting the system using internal capacity, as in accordance with the contract establishing the joint venture such amount will be paid in dividends to the other participant.

Moreover, the dividends received by Riga Traffic from LLC Riga Map, which in accordance with the business plan over the period of 13 years may reach up to LVL 7.7 million, shall not be included into the calculations regarding Riga Traffic losses and the subsidy to be allocated, thereby not decreasing the losses to be compensated by the subsidy by this amount.

Riga Traffic during three months of 2009 without substantiation collected LVL 594 thousand from passengers, unlawfully increasing the payment for purchase of one-time ticket at the driver's, while passengers did not have an opportunity of purchasing one one-time ticket elsewhere.

Auditors concluded that established fare relief system is not managed effectively, as it does not ensure losing of preferential status attributed to a smart card, when the prerequisite of receiving a passenger fare relief expires.

Audit “Efficiency and lawfulness of the logistics supply and provision system of the National Armed Forces”

Audit objective was to evaluate the compliance of the supply and technical provision system of the National Armed Forces with the requirements of the regulatory enactments and the development goals of the forces of the North Atlantic Treaty Organisation (NATO).

The multi-level supply and provision system of the National Armed Forces (NAF) established by the Ministry of Defence (MoD) is complicated and inefficient; the resources required to ensure it is working exceed the gains as the system aims are not achieved and at least LVL 1,227,411 from the state budget have been spent inefficiently, the State Audit Office has revealed in the audit.

At least LVL 501,577 have been used inefficiently in the process of purchasing minesweeper ships of the National Armed Forces and introducing the new type of field uniform has resulted in an unreasonable cost increase of at least LVL 725,834.

The MoD has failed to develop a common policy in the state military procurement area and efficient military procurement system. For example, although the information about procurement of armament and ammunition of National Armed Forces is considered confidential, the MoD has proposed open tender method to the Cabinet of Ministers for procurement of armament for the National Armed Forces, while the exception provided for in the law has been applied to uniform components, including boots, thus positioning such procurement as essential for protecting state interests.

The facilities offered by the NATO Maintenance and Supply Agency (NAMSA) have not been used for centralised National Armed Forces procurements before 2009.

The MoD has allowed long-term contracts for upgrades of individual troop equipment and armament amounting to at least LVL 46.5 million to be concluded without sufficient substantiation of the required quantities.

The MoD has failed to implement a system for monitoring the NAF capability development projects, resulting in development projects proposed by the National Armed Forces being accepted and long-term liabilities being assumed without sufficient evaluation and establishing national priorities, thus leading to a risk of failure to fulfil financial commitments.

Audit “Legality of Procurement of National Armed Forces Minesweeper Ships”

Audit objective was to assess the compliance of the actions by the Ministry of Defence and structural units of the National Armed Forces with the requirements of regulatory enactments in the planning and arrangement of the acquisition of minesweeper ships and technical documentation for such ships for the National Armed Forces.

It was disclosed in the audit that by concluding the agreement on procurement of five minesweeper ships from the Royal Dutch Naval Forces, the Ministry of Defence has undertaken, without sufficient assessment, long-term financial liabilities until the year 2012 amounting to EUR 57 million. With a reduced national defence budget, the Ministry of Defence will be unable to honour its financial liabilities and ensure the appropriate maintenance and use of ships.

Annual Report 2010

The Ministry of Defence failed to ensure sufficient assessment of the indispensability of the procurement of minesweeper ships and the impact of the planned procurement on the state budget, therefore the information submitted to the Cabinet of Ministers required for taking the decision on the procurement of the minesweeper ships from the Royal Dutch Naval Forces and the financial justification thereof was insufficient.

The National Armed Forces had not established the requirements for implementation and use of the new minesweeper ships and therefore the total cost of the procurement project was unknown.

The Ministry of Defence did not ensure a high-quality assessment of the agreement project; therefore the Ministry of Defence incurred unnecessary expenditure of state budget funds amounting to at least LVL 93 951 through the completion of the agreement.

The MoD had not implemented a system to ensure adequate supervision of the minesweeper ship procurement project and did not control and coordinate the cooperation of the units of the Ministry of Defence and the National Armed Forces involved in the procurement project.

Although when notifying about the necessity of procurement of the minesweeper ships, the Ministry of Defence had notified the Cabinet of Ministers of its decision to refuse the offer of the Netherlands to translate the technical documentation of the ships, pointing out that the translation of documentation shall remain the responsibility of Latvia, the officials of the Ministry of Defence and the National Armed Forces failed to carry out timely measures to ensure the translation of the documentation. At the same time the Ministry of Defence took an unjustified decision to purchase documentation in English, and LVL 407 626 were used for procurement of another ship documentation set in English.

Audit “Compliance of Storage, Sale and Destruction Provision of Material Evidence and Arrested Property with Requirements of Regulatory Enactments”

Audit objective was to gain assurance that a system has been created and introduced that ensures lawful and effective use of State budget funds allocated for the storage, sale and disposal of material evidence and arrested property and ensures timely exchange of information and decision-making regarding the handling of material evidence.

It was found during the audit that the procedures for the storage and destruction of material evidence and arrested property are deficient.

Due to deficiencies in regulatory enactments the State budget funds are utilised without substantiation for storage of material evidence and used resources are not collected in full amount from the persons found guilty.

As a result of deficient regulatory framework criteria, in accordance with which material evidence shall be stored with a person directing the procedures or shall be handed over for storage at the Provision State Agency (the Agency), are not established. The State Audit Office recommends the Ministry of Interior to initiate amendments in the regulatory enactments, in order to establish single procedure for storage and destruction of material evidence. SAO disclosed that the State Police does not always observe internal regulations and that material evidence is also stored in working offices of investigators and inventories of material evidence are not performed.

Annual Report 2010

Regulatory enactments also do not specify responsible officials for inclusion of complete and accurate costs related to storage, sale or destruction of material evidence into procedural costs, thus funds utilised from the State budget are not recovered from the persons found guilty.

The Agency does not ensure gathering of precise information on accounting of expenditure related to taking over, storage, sale or destruction of material evidence confiscated in each control case, thus out of 33 control – in total, not including into costs by LVL 13 503 less.

In accordance with external regulatory enactments both the Agency and the State Revenue Service have simultaneously created systems to ensure storage, sale or destruction of property (the Agency – of material evidence and the State Revenue Service – of confiscated property), besides handing over of confiscated material evidence from the Agency to the State Revenue Service creates additional costs for moving the property and repeated evaluation.

It was disclosed that inventories in the Agency are performed formally and material evidence record data does not correspond with the quantities indicated in inspection protocols. The system developed for record and control of material evidence is incomplete and the Agency does not provide precise information on amount of stored material evidence.

The Agency utilises the State budget funds without substantiation for storing material evidence, as the institution does not ensure timely implementation of adjudications of persons directing the proceedings, putting on sale, destroying of material evidence or returning thereof to owner. Thus during the audited period the Agency continues storing material evidence in 143 cases or in 19.3 % of total number of cases, where the final judgment has been taken and has entered into effect regarding action with material evidence. In turn, in 11 cases out of 33 control cases included in the sampling the Agency has not timely commenced implementation of adjudications of persons directing the proceedings, thus the State budget funds were utilised without substantiation at least in the amount of LVL 75 thousand.

The Agency has not ensured analytical accounting of resources in the amount of LVL 1 million obtained through sale of material evidence and transferred to the deposit account, inventory of account has also not been performed, thereby SAO disclosed that in the deposit account there are still resources at least in the amount of LVL 64 thousand, which in accordance with the judgment shall have been transferred to the State budget or returned to owners. In addition to that resources of the deposit account at least in the amount of LVL 10 thousand were not used in accordance with the objective.

Audit “Evaluation of the Compliance of Activities with the Requirements of Regulatory Enactments and Effectiveness of SJSC Road Traffic Safety Directorate”

Audit objective was to evaluate the compliance of the governance and activities of SJSC Road Traffic Safety Directorate (RTSD) with the requirements of regulatory enactments and the effectiveness of its operations.

Annual Report 2010

It was established during the audit that a more effective exercise of the functions of the shareholder of the state capital company would facilitate the improvement of the operational performance of the RTSD.

During the audit, the State Audit Office has found that the governance policy of the SJSC *Road Traffic Safety Directorate* implemented by the Ministry of Transport (MoT) requires improvement in order to ensure effective fulfilment of functions as the shareholder of the RTSD.

The MoT, as the holder of the capital shares of a State capital company, is entitled to influence the operational strategy of the RTSD, including the setting of the company's performance targets, balancing the social and financial objectives of its operations and to assess regularly the implementation of the strategic goals and return on the assets invested. The MoT has not taken full advantage of this right, as a result of which the RTSD develops and implements long-term development plans, setting its own profit share and the scope and direction of investment.

The RTSD approves the rates for the services that are being provided as part of fulfilling the delegated State administration assignments. Accordingly, the requirement of the regulatory enactments providing for the authority of the Cabinet of Ministers over the approval of such rates has not been observed, and State monitoring of the performance of assignments that are being fulfilled in a position as a monopoly is not being provided.

Regardless of the fact that the RTSD's own requirement to earn a profit of 10% is being met as a result of the application of the current rates, the rates of certain RTSD services are being set unjustifiably, without linking them to the cost of the service or by cross-subsidising other services. Thus, customers are overpaying for some services (such as the State technical inspection of vehicles) and paying below the cost of the service or receiving a free service (such as vehicle write-offs) in other cases.

Auditors found that the transfer of technical control services to private companies has taken place without arranging open selection procedures, thus failing to ensure equal competition opportunities for all private merchants in the vehicle technical control market. The SAO points out the risk that future accreditation to perform technical control services will also be formalistic as the merchants that have operated in the technical market for the last 15 years have acquired considerable advantages to ensure continued accreditation.

The RTSD has also created a favourable financial environment for the accredited private companies, ensuring the profitability of their operations. This has been achieved by transferring to commercial operators technical control stations with high vehicle flows and a favourable repayment period for investments but not control stations with a low vehicle flow (Balvi, Aluksne and Gulbene).

The SAO points to deficiencies in regulatory enactments, which have caused budget revenues to be affected. Even though regulatory enactments provide for penalties for drivers who drive vehicles without a valid technical inspection, they do not contain mechanisms and drivers' responsibility for proper storage or disposal and removing from the record vehicles that have not undergone technical inspection for an extended period. Approximately one half or 46.8% (537,640), of the registered vehicles as of 1 January of the current year did not have a valid technical inspection.

Annual Report 2010

Due to deficiencies in regulatory enactments, at least LVL 199 thousand in State fees for vehicles with valid technical inspection were not transferred into the budget in 2009, as regulatory enactments only provide for duty payment only for the current year but do not require such payment if the vehicle has been registered in Latvia in the previous years but no duty has been paid for it.

Audit “Performance of the Function of Construction Supervision and Control after the Reorganisation of the State Construction Inspection”

Audit objective was to establish whether, following the reorganisation of the State Construction Inspection, the regulatory enactments ensure a safe construction process; how the performance of the function of construction supervision and control is ensured in practice; how examinations of the compliance of construction products with technical regulations are generally ensured in the country; and how the anticipated financial benefits have been achieved through the reorganisation of the State Construction Inspection.

It was found during the audit that the liquidation of the State Construction Inspection has weakened the building supervision control and has not provided fiscal gains to the extent anticipated.

After the reorganisation of the State Construction Inspection (SCI) the control of the construction process in the country has decreased and deficiencies in the legal regulation and activity of the responsible authorities affect the safety of consumers.

The direct state control over the construction process has physically not been conducted since June 2009 when this function was deleted from the list of tasks of the Ministry of Economics (ME) by amendments to the Construction Law, maintaining only general policy supervision and coordination for the ME in the area of construction. After the reorganisation of the SCI the local government construction inspectors are the only officials who supervise construction in the administrative territory of the local government.

Auditors disclosed that construction inspectors do not conduct regular inspections during the construction process at local governments, leaving it mainly for the closing stage of the construction when the building is commissioned. The SAO calculated that on average 0.16 inspections per one commissioned object were conducted in 2009. During that period local government construction inspectors conducted 71% less inspections than the SCI during 2008.

The SAO also indicates that the independence of the local government construction inspectors is questionable, because in the cases where the construction is performed by the local government itself the supervisors thereof concurrently have employment relations with the supervised local government.

Construction inspectors inspect construction objects according to differing approaches and principles, because the general construction coordination in the country is insufficient. For example, minimum actions to be taken when controlling the legality of the construction process have not been specified, types of buildings, stages of the construction process or buildings requiring mandatory inspections have not been determined. The inspections generally are not documented, thus prohibiting

ascertainment on whether or not supervision is exercised legally and according to the technical requirements.

The situation where the number of construction objects supervised by one construction inspector ranges from three to 134 reveals the insufficient capacity for the supervision of the construction process in densely populated administrative territories of local governments.

The remuneration of construction inspectors does not depend on the workloads of the construction inspectors and considerably differs in different construction boards. For example, at two construction boards who both issued 21 construction permits last year, the monthly salary was LVL 730 and LVL 1707 respectively. At the same time there are construction boards where such salaries are paid in the cases where the number of issued construction permits is 7 to 8 times larger. The monthly salary of local government construction inspectors in 2009 was within the range from LVL 191 to LVL 1707.

By reorganising the SCI in order to achieve the fiscal consolidation objectives only 59% of the initially estimated savings of LVL 104 thousand were saved in the second half of last year. That happened because the government (the Consumer Rights Protection Centre, Public Utilities Commission and the Ministry of Economics) had to take over a part of the functions of the SCI.

It was not possible to gain assurance whether the methods and criteria applied by the Consumer Rights Protection Centre (CRPC) for selecting the merchants to be included in the check sample effectively ensured identification the merchants who offer unconformable construction products on the market. Within the audited time period only 4% of the total CRPC checks were conducted in the construction product manufacturing sites despite approximately 20 to 30% of construction products are purchased directly from the manufacturer rather than at the points of sale. Meanwhile, CRPC has checked only eight or approximately 22% out of the total 37 regulated construction product groups at the construction product manufacturing, storage and sales locations.

Audit “Compliance of the administration of compensation of losses caused to the environment with the provisions of regulatory enactments and the effectiveness of loss compensation”

Audit objective was to gain assurance that the regulatory enactments governing the compensation of losses caused to the environment are sufficient and appropriate in order to ensure the restoration of the environment; whether the authorities involved in the administration of compensation of losses caused to the environment are functioning in accordance with the requirements of regulatory enactments; and whether the system of administration of compensation of losses caused to the environment is effective.

It was established during the audit that the administration of penalties for environmental violations and losses is not sufficiently effective to restore the natural resources destroyed.

The audit included inspections at the Ministry of Environment and institutions subordinate to it: the State Environmental Service and the Nature Conservation Agency; as well as at the Ministry of Agriculture and its subordinate institution, the State Forest Service.

Annual Report 2010

The administration of compensation of damage caused to the environment, forests and hunting resources is not sufficiently effective, and the existing system of penalties is not proportional.

The duplication of functions and uncoordinated actions of the authorities involved both in environmental protection and in the control of forest and hunting resources – the Ministries of Environment and Agriculture, respectively – is being permitted.

As a result of the decreased capacity of the authorities controlling environmental violations and forest offices, the risk of an increase in undetected violations has grown. The reduction of the number of inspectors of the regional environmental boards of the State Environmental Service by approximately 30% has caused a decrease of 50% in the inspections conducted, which is one of the reasons for the decrease in the volume of fines calculated to the state budget by LVL 96 thousand or 30%.

Whereas, as a result of the reduction of the number of forest-guards of the State Forest Service by an average of 36% while increasing the area of surveillance by as much as 65% has led to the inspections conducted to fall by 83%, which is one of the reasons for the decrease in the volume of fines calculated to the state budget by LVL 29 thousand or 38%.

It was disclosed during the audit that, as a result of inappropriate application or failure to comply with regulatory enactments detected in the activities of the environmental protection authorities, losses and administrative fines for environmental damage in the amount of at least LVL 48 thousand were not calculated in the period subject to the audit.

Regulatory enactments contain no mechanism that would motivate violators to pay the administrative penalties imposed. The amount of fines not collected for the state budget, imposed as a result of forest protection violations and for losses caused in the period of the audit at the regional forest offices included in the inspections constituted at least LVL 855 thousand.

The SAO points out the necessity to legally commensurate the applied penalties. At present, significant violations, such as unauthorised fishing, are not being distinguished from less significant violations, such as inappropriate labelling on nets. Therefore, a situation may emerge where unreasonably heavy penalties are imposed for insignificant violations or no penalty is imposed at all. A similar provision – that criminal liability applies to violations of angling regulations in a specially protected State nature territory – is not proportional to the violations committed, such as angling without an angling card.

Auditors were not assured of compliance with the requirement of a Directive of the European Parliament and of the Council providing that the mechanisms of compensating environmental damage must ensure the restoration of the damaged natural resources.

Sustainable management of State forests is not currently being ensured sufficiently, as regulatory enactments do not provide for an environmental impact assessment to be conducted in cases where several clear cuttings are being planned together in a forest, which is a practice pursued at present by the largest State-owned forest management company, the State Joint Stock Company *Latvian State Forests*, without conducting an environmental impact assessment.

Audit “Compliance of the Activities of the Ministry of Agriculture Research Institutions with the Requirements of Regulatory Enactments and Possible Optimisation of the Industry Research Institutions”

Audit objective was to gain assurance that the activities by the scientific institutions under the supervision of the Ministry of Agriculture (MA) comply with the requirements of regulatory enactments, and the established institutional structure is rational and ensures effective attraction of funds and utilisation thereof for scientific activities.

It was found during the audit that the activities of the scientific institutions of the Ministry of Agriculture and the research carried out do not promote a focused development of the sector.

The prior scientific research directions of the said industries referred to in regulatory enactments are defined so widely that they practically allow granting of financing to any research within the industry. The industry policy planning documents developed by the MA also do not specify the scientific research directions to be supported. The goals and attainable results of research projects are practically defined by the scientists or research institutions themselves.

Even though the MA is responsible for the industry development, its possibilities to affect the government order of scientific research and the distribution of its financing are limited, as the regulatory enactments only provide for partial, if any, involvement of the MA representatives in the selection of projects. In 2009, the MA directly administered just 11% of the financing granted for the research performed by research institutions.

The SAO also points out some imperfections in the supervision of the MA research institutions. The planning and actual operation of the activities of the research institutions show that the supervision of the institutions by the MA and Latvia University of Agriculture (LUA) is not efficient enough, and one is not convinced that the structure of the research institutions is optimal enough and that it is directed toward a purposeful implementation of scientific activity and an effective use of resources, especially with regard to the LUA agencies.

Some deficiencies in the regulatory enactments in relation to the calculation of basic financing for scientific activities were found, as they did not accurately define the contents of information for the calculation of basic financing and permitted different interpretations of the requirements of the regulatory enactments in relation to the responsibility of supervisory institutions in examination of data.

Project estimates and reports of research institutions on the use of financing are often just formal. Likewise, no supervision is performed to ensure adequate and effective use of the financing granted to project implementations, as several projects have been attributed expenses that are not related to the project goals.

Contrary to the founding purpose of the institutes, the basic activity of several research institutions is the provision of paid services, and not scientific activity. For example, it was established during the audit that, in 2009, the income from scientific activity of the Research Institute of Agricultural Machinery (an agency of the LUA) in implementing only two projects, comprised only 17% of the agency's total income. Another LUA agency, the Research Institute of Land and Water Management, performed commercial activity by providing such paid services (sale of soil mixes) that are prohibited for a public entity.

Besides, not all research institutions have complied with the requirements for the registration of a research institute in the Register of Research Institutions by observing the requirement set out in the regulatory enactments as to having a certain number of scientists with a doctorate degree in the institute. Not all research institutions have performed sufficient evaluation of the structure and load of the research staff used in projects, to ensure a proportionate number of staff in the research, technical and service departments.

The remuneration policy applied in research institutions is not transparent and is not based on clearly defined basic principles. For instance, the Leading Researcher of LUA received a monthly remuneration from the state research programme in the amount of LVL 355 for three hours of work. Research Leaders of the projects co-funded by the European Social Fund receive up to LVL 2392 per month, which substantially exceeds the pay for several other synchronously implemented projects.

Audit “Evaluation of the effectiveness of implementation and compliance with regulatory enactments and the legal framework of the project *E-government Portfolio*”

Audit objective was to evaluate the effectiveness of implementation and compliance with regulatory enactments and the legal framework of the project “E-government Portfolio” of the national programme of the European Regional Development Fund of the European Union, “Development and improvement of the infrastructural foundation for electronic governance”.

It was found during the audit that the project “E-government Portfolio” was not appropriately and justifiably planned and implemented. The SAO has calculated that a total of LVL 315 thousand has been used inefficiently in the project implementation.

A total of LVL 3.3 million was invested in the project, but since the activities and objectives of the project were not linked to specific functions or processes, the results of the project do not permit an evaluation of whether or not the funds invested have been an economical solution for the implementation of the project.

The planned result of the project – optimisation of State administration and local government performance was not achieved. Even though the project had proposed to integrate information systems into a single State information system, two separate and mutually unconnected record management systems were developed, as well as a project management system that ensures partial recording of the progress of a single e-government and information technology process. LVL 122 thousand has been administered inefficiently in the creation of the project management system.

It was found during the audit that an insufficient number of user licences for the record management systems had been acquired as part of the project. Accordingly, five of the 17 institutions have acquired additional licences worth LVL 45 thousand, whereas one institution has commenced implementing a new record management system due to the insufficient number of the licences. LVL 42 thousand was used inefficiently in purchasing licences for the record management system, as the project failed to evaluate the possibility of expanding the use of *DAUKS*, the system of electronic circulation of documents.

Annual Report 2010

The implementing party of the project has used LVL 138 thousand on outsourcing the development of regulatory enactments and by-laws of structural units to an external service provider, although this was one of the functions of the institution. Moreover, documents were developed as part of the project that was not used in the period evaluated by the audit.

A total of 58% or LVL 1.9 million, of the total project funding has been used for activities for which no regulatory framework exists at the national level, such as the introduction of a project management system, the creation of infrastructure for e-services and the development of e-services.

Audit “Lawfulness of municipal functions in handling of property and financial resources in the municipality of Ropazi Region”

Audit objective was to obtain assurance that the handling of property and financial resources in the municipality of Ropazi Region is in compliance with the requirements of regulatory enactments.

It was found during the audit that the Ropazi municipal government has operated with municipal property and financial resources in an unlawful manner.

The municipality of Ropazi Region has broken the requirements of the law by permitting unreasonable expenditure of state and municipal resources amounting to LVL 321 thousand (excluding VAT) and violated the principle of good governance when renting and alienating properties.

The principle of equality and impartiality towards all candidates has not been observed in the procurements organised by the municipality and the transparency of procurement procedures has been insufficient.

In six cases of procurement, the Procurement Commission of the municipality has not complied with the requirement of the law to post notifications on the internet home page. The sole candidate having applied has been declared the winner in several tenders. Furthermore, in one case the contract was concluded before selecting the winning entry, which points to a possible prior arrangement.

In two cases the municipality has increased the contractual price of the procurement for additional works by LVL 95 thousand (excluding VAT) without approval of the Procurement Control Bureau, thus ignoring the procedure prescribed by the law.

The municipality has used LVL 256 thousand (excluding VAT) unlawfully through unlawful construction as it had failed to prepare the technical projects in six procurements, without which it is impossible to prepare economically reasonable construction cost estimates.

The municipality has used LVL 65 thousand (excluding VAT) without substantiation using the funds for additional works in two procurements, which cannot be proved with paperwork.

The SAO has also disclosed that the municipality has mismanaged financial resources by not collecting contractual penalties amounting to at least LVL 18 thousand (excluding VAT) for delayed construction works.

Annual Report 2010

The SAO has disclosed that 13 land plots (11.425 ha) have been listed as free state lands only eight days before the final date of submission of land requests stipulated by the law. Furthermore, the inheritors of the lands are not notified of the opportunity to the priority of receiving a land plot equal to the inherited estate, although respective land plots have been listed as state free lands and granted to other persons as the only candidates.

In 52 cases the decision on granting the land into permanent use was taken sooner than in one month following the first request, as stipulated by the law. In one case the Development Committee has issued its resolution even before the request.

4.2. Financial audits

During financial audits, auditors perform the necessary inspections to obtain sufficient audit evidence and to assess whether financial statements contain no substantial errors or irregularities; they assess whether a financial statement has been produced in compliance with the requirements of regulatory enactments and generally accepted accounting standards.

Audit of the Annual Report of the Republic of Latvia for 2009 on the implementation of the State budget

The audit objective: to examine whether the 2009 annual report of the Republic of Latvia on the implementation of the State budget and budgets of local governments (Financial Year Report) complies in all key aspects with the financial statements from which it has been derived.

It was found during the audit that significant improvements are required in the State resource management processes.

Even though the Report corresponds to the statements from which it has been derived in all key aspects, deficiencies were detected in the reporting of long-term investments: the value of these has been underreported by no less than LVL 221 million, as LVL 19 million has been reported under current assets and LVL 202 million has been reported as sub-balance items.

The most important findings, conclusions and recommendations of the audit arise from events, processes, decisions and transactions that affect the result of the consolidated State balance sheet in substance, or which characterise the financial position of the State, rather than merely provide assurance of the correctness of the accountancy principles applied.

Pursuant to legal norms, the State budget is a means for the implementation of State policy using financial methods; however, in actuality, budget policy is implemented as a separate policy, without links to national policy objectives and achievable results. Therefore, in the reporting year, fiscal discipline measures have not produced the desired outcome, and ineffective and unproductive use of financial resources has been permitted.

In 2010, the government and the Minister of Finance decided on fiscal discipline measures on multiple occasions, including mathematically equivalent expenditure reductions. As the obligations already assumed by the budget institutions were not considered, significant reallocation of funds took place during the reporting year among budget programmes and sub-programmes, and decisions were made on allocations from funds for unforeseen events to increase expenditures that should have been

Annual Report 2010

reduced or limited previously (for compensation, for procurement of goods and services, for building equity capital, etc.). Thus, even though the actual deficit of the consolidated State budget in 2009 was LVL 161.4 million less than initially planned, through allocation of funds from the budget sub-programme for unforeseen events, it has been increased by LVL 69 million.

Although regulatory enactments provide for responsibility to use budget funds effectively, efficiently and productively, the auditors have noted in the Report the most important findings from 2009 audits regarding instances where authorities have assumed unproductive obligations, both in implementing projects and in providing services to members of the public.

As there are no common criteria to determine and measure returns on State capital, it is impossible to gain assurance regarding the results of managing State and municipal assets worth LVL 2,560 million and regarding the fact whether capital companies have been governed as efficiently as possible and in compliance with State interests.

Transactions involving the Joint-Stock Company *Parex banka* have had a significant impact on the financial position of the State: as a result of these, the foreign debt of the State was increased significantly, as LVL 265 million, or 17% of the funds received as part of the International Loan Programme, have been used on term deposits to repay loans syndicated at the bank.

Following the audit, the recommendations were issued to the responsible authorities, the implementation of which would ensure a more effective and productive use of State and municipal funds and property in the future and promote the restoration and sustainability of economic growth.

The recommendation to link the State budget planning and implementation process to the State policy, its objectives and achievable results has been emphasised as the most important recommendation. It is to be implemented by introducing the drafting of the State budget law for the medium term, corroborating the results to be achieved with the allocated resources in the law, and providing for strict accountability for the results achieved. Additionally, measures must be undertaken to ensure the implementation of a common State human resource policy: measurable tasks should be defined against human resource management processes within the State administration overall and in each individual institution, which would enable the effectiveness and operational results to be evaluated. Whereas, for the purpose of promoting returns on State capital, a policy of governance of State-owned and municipal capital companies should be developed, which would define the results expected from the operations of such capital companies and the aims of State and municipal investments. These audit recommendations were also submitted to the Prime Minister.

Audits of the 2009 financial statements of ministries and other central government institutions

In 2010, the State Audit Office conducted 26 audits regarding the correctness of preparation of financial statements for 2009 by ministries and other central government institutions.

The objective of these audits was to examine whether the 2009 financial statement, in all the key aspects, presents an accurate view of the financial position of the institution as of 31 December 2009 (financial position and operational performance), and whether it has been drawn up in accordance with the requirements of the regulatory enactments applicable in the Republic of Latvia.

Annual Report 2010

Figure 3. Opinions issued to ministries and other central government institutions regarding their 2009 financial statements

Unqualified opinions	Qualified opinions	Total opinions
20	4	24

Altogether, the State Audit Office provided 24 opinions regarding the correctness of preparation of the 2009 financial statements by ministries and central government budget institutions; of these, unqualified opinions were provided in 20 cases and qualified opinions in four cases.

In six cases where qualified opinions were not issued, the State Audit Office highlighted certain circumstances, stressing important issues related to future events that may affect annual reports.

The facts established during audits have been discussed with the officials in charge at all ministries and central government budget institutions; in addition, subsequent steps, measures to be implemented and periods for the elimination of the deficiencies found have been agreed upon with the audited units. The State Audit Office has provided a total of 331 recommendations to the audited entities, of which:

- 20 are high-priority recommendations. This means that errors and irregularities point towards substantial irregularities in the annual report, and a modified opinion has been issued to the audited entity. The State Audit Office expects that the audited entities will solve these questions within six months after the issuance of the opinion regarding the annual report;
- 114 are medium-priority recommendations. Errors and irregularities, including deficiencies of the control system, indicate a risk that a modified opinion may be issued for the next annual report. The State Audit Office expects that the audited entities will solve these questions before the next annual report is drawn up;
- 197 are low-priority recommendations. This means that the findings are of less importance, yet solving these issues would improve the preparation of the annual report. With respect to these findings, the State Audit Office expects that the audited entities will address these issues no later than within two years after the opinion was issued.

Qualified opinions

The State Audit Office issues qualified opinions in cases where an audit finds substantial errors by value that affect one or more sections of the annual report.

The State Audit Office has issued qualified opinions regarding the 2009 annual reports of the Ministry of Finance, the Ministry of Transport, and the Ministry of the Interior and the Ministry of Health:

- in the consolidated report of the Ministry of Finance, State-owned immovable properties worth LVL 156 million, which have been transferred into the management of a State capital company, have been reported as sub-balance items rather than as long-term investments within the balance sheet, as a result of which the assets of the Ministry of Finance have been under reported by LVL 156 million in the report;
- in the consolidated report of the Ministry of Transport, the funds transferred to local governments for ensuring domestic flights have been reported as subsidies to State

Annual Report 2010

and municipal merchants rather than transfers to local governments, as a result of which the expenditure “Subsidies to State and municipal merchants” has been over reported by LVL 2.3 million, whereas the expenditure “Earmarked State budget subsidies to local governments for maintenance expenses” have been under reported by LVL 2.3 million;

- the consolidated report of the Ministry of the Interior does not provide a clear and fair view of the use of LVL 3.1 million, as no assurance has been gained regarding the closing report of the Latvian Police Academy;
- the consolidated report of the Ministry of Health does not provide a clear and fair view of the use of LVL 1.7 million, as no assurance has been gained regarding several balance items of the Emergency Medical Service.

Unqualified opinions with an emphasis of circumstances

The State Audit Office issues unqualified opinions with an emphasis of circumstances in cases where it is necessary to highlight significant issues related to the continued operations of the audited entity, or there is significant uncertainty, the resolution of which depends on future events and may affect the report.

The State Audit Office has issued unqualified opinions with an emphasis of circumstances for the 2009 annual reports of the Ministry of Defence, the Ministry of Welfare, the Cabinet of Ministers, the Ministry of Agriculture and the Ministry of Education and Science:

- in the consolidated report of the Ministry of Defence, the provisions of the Cabinet Regulation “Procedures According to which Budget Institutions Organise Accounts” have not been complied with, and the amount of future obligations reported in the sub-balance account are by at least LVL 43 million lower than the actual obligations of the Ministry, as the Ministry of Defence has not defined unified principles and criteria for the evaluation of contracts concluded by institutions subordinated to the Ministry and accounting for future obligations. The said amount includes contracts regarding the acquisition of weaponry, equipment and specialised equipment for the National Armed Forces, which provide for supplies and payments until 2014, without providing for a possibility of reducing the volume of the supplies and to revise the size of the payments;
- the management statement of the consolidated report of the Ministry of Welfare contains information on the closure of three branches of State social care centres in 2010 in accordance with the *Plan for the optimisation of State-funded social care and social rehabilitation services in circumstances of reduced funding for 2010-2012*, yet the 2009 annual reports of these care centres have been prepared in compliance with the principle of continued operations – which is based on the assumption that the authority will be able to continue operations over a period that is not shorter than 12 months following the date of preparation of the report;
- the consolidated report of the entity “Cabinet of Ministers” has been prepared in compliance with the principle of continued operations, even though it was found during the audit that serious doubts exist regarding the capability of the School of Public Administration to implement successfully the functions prescribed by regulatory enactments and to continue independent operations in the near future.

The grant to cover expenses allocated to the School of Public Administration in 2010 was LVL 510, or 1% of the amount of the grant intended for the School in 2009. Whereas own revenues from the lease of premises and organisation of training events were planned to reach LVL 100,000 in 2010, which is 2.6 times the revenues

Annual Report 2010

earned in the year before, whereas in the period from 1 January to 24 March 2010, the School of Public Administration had earned own revenue of LVL 3,441, which constitutes only 3% of the planned own revenues. Payments made for services received to ensure the operations of the School were LVL 17,000, which exceeds the revenues earned by four times. Payment for services was effected from the advance funds transferred by the State Chancellery;

- the asset item "Debtors" of the consolidated report of the Ministry of Agriculture cites State land amelioration systems and land amelioration systems of national significance valued LVL 19 million, as a result of which the balance sheet asset item "Long-term investments" has been underreported by LVL 19 million, while the value of the balance sheet asset item "Current assets" has been over reported;
- the information included in the consolidated report of the Ministry of Education and Science regarding the number of immovable property units differs from the data in the National Real Estate Cadastre Information System.

According to information from the State Land Service, there are a total of 2,135 units under the ownership title or legal possession of the Ministry and institutions subordinate to it, whereas, according to the information provided in the consolidated report of the Ministry, the figure is 2,580.

On deficiencies in regulatory enactments

In conducting audits regarding the correctness of preparation of the 2009 financial statements by ministries and other central government institutions, the State Audit Office also draws attention to the following findings, which should be addressed with appropriate changes in the regulatory enactments issued by the Cabinet:

- Cabinet regulations do not contain a requirement where, in case of a holding company, if the parent company is a State capital companies and the subsidiaries are fully owned by the parent company, the dividend should be determined from the profits in the consolidated report.

Accordingly, it was found in an audit at the Ministry of Transport, that no revenues were received in the State budget from the 2008 profits of the subsidiaries of SJSC *Latvia Railway* in the amount of LVL 9.5 million;

- the regulatory enactments governing the remuneration system of State sector employees, currently in effect in the country, are deficient, as, in defining the degrees of remuneration and qualifications, the specific nature of the operations of the institutions and other parameters affecting the complexity and intensity of work are not considered.

The deficiencies of the regulatory enactments have created a situation where the State Agency *Civil Aviation Agency* uses the structure of the institution to increase the remuneration of its employees – by artificially inflating the number of managers: the heads of three structural units had no subordinates during 2009, whereas the heads of eight structural units had one subordinate. The staff shortages and the disproportionately low remuneration versus other employees in the industry have been pointed out by an audit conducted by the International Civil Aviation Organization, classifying it as an irregularity.

On the legality, efficiency and usefulness of the handling of resources

Significant facts were found during audits that indicate inefficient and unproductive operations with State resources, and the State Audit Office invites an evaluation of the actions of the responsible officials. For example, it was found at the Ministry of Defence and institutions subordinate to it that considerable funds are channelled towards payment for consulting services; at the Ministry of Foreign Affairs, payments have been made to employees for various additional tasks, and expenses have been covered incurred by persons who have no legal employment relations with the Ministry; at the Ministry of Economics, deficiencies have been found in the collection of late fees or contractual penalties, which means revenues were not received at institutions subordinate to the Ministry; the Ministry of Education and Science has failed to observe the restrictions instituted by fiscal discipline; at the Ministry of the Interior, facts have been established indicating mismanagement and inefficiency in handling State budget funds; at the Ministry of Health, activities have been detected that indicate unproductive use of resources and failure to observe the requirements of fiscal discipline; etc.

5. Priority directions for next year

In 2011, the State Audit Office continues to improve the quality of its work, ensuring that audits are conducted on topics of special interest to the public, noting deficiencies and instances of squandered funds, facilitating effective management of State and municipal financial resources and, where possible, noting financial impact. Audit themes have been defined considering the audit priorities set forth in the Operational Strategy of the State Audit Office for 2010-2013 and the violations and deficiencies detected during financial audits.

The State Audit Office continues to actively contribute to the activities of the Public Expenditure and Audit Committee of the Saeima (hereinafter: the Committee) as it fulfils the function of monitoring the economic stabilisation process of Latvia. The State Audit Office provides support to the Committee, both in drafting materials for review at the meetings organised by it and in evaluating the draft documents produced by the responsible institutions and submitted to the Committee, as well as other information. The Committee also reviews audit reports and the implementation of audit recommendations.

The State Audit Office continues to take active stances and to express its own proposals and perspective on the processes taking place in the country and the measures to be taken to improve the financial system. Both in its audit work and in its participation in the activities of the Committee, the State Audit Office has concluded that there are substantial deficiencies in the financial management system, which prevent an assessment of effective and productive use of State budget funds – which is why improvements are required in regulatory enactments.

The State Audit Office tracks the implementation of the audit recommendations issued in 2010. Upon conducting the financial audit of the 2009 annual report, the State Audit Office prepared and submitted to the Ministry of Finance and to the Prime Minister important audit recommendations that would significantly improve financial management. The implementation of these recommendations would ensure the introduction of result-oriented principles in State administration and would enable assessment of the effectiveness of the operations of budget-funded institutions, as well as those of State and municipal capital companies.

In order to promote the further implementation of the results of its activities, the State Audit Office has commenced active cooperation with the Office of the Prosecutor

Annual Report 2010

General: State Audit Office staff organise training sessions for prosecutors in order to enhance the prosecutors' understanding with respect to financial violations committed by institutions, including accounting violations; additionally, information exchange is being facilitated with prosecutors by providing them with additional data and information regarding documents reviewed during audits.

The State Audit Office continues to be actively engaged in international cooperation: both by participating in international auditing activities, by contributing to working groups of international bodies, by sharing its expertise and providing professional support to other supreme audit institutions, thus reinforcing its recognisability and authority among foreign institutions.

In late 2010, the European Union Contact Committee approved the activity "Exchange of experience on conducting audits of the governance of State-owned and municipal capital companies". The State Audit Office has undertaken to direct the implementation of this activity and will request information on audit-related issues from other member states of the European Union, considering the previous experience of these states with conducting audits in the transport and communications sector.

In June 2011, representatives of the State Audit Office will participate in the VIII EUROSAI Congress, and active preparations are already underway for the Congress proceedings: in connection with the Congress theme, an opinion of Latvia as a member state was drafted on the subject of the "Role of Supreme Audit Institutions in Promoting Accountability among State Administration Officials", as well as an article, "Supreme Audit Institution: A Guarantee of Transparency and Good Governance in a Democratic State", for publication in a collection dedicated to the 20th anniversary of EUROSAI.

Another important event will be the meeting of Baltic and Nordic supreme audit institutions at the level of institution heads, to be held in late August in Oslo, Norway.

The staff of the State Audit Office will continue their professional development: in 2011, in the majority of cases, the Office's own staff members have organised training events for their colleagues both on audit work and on the enhancement of other skills; experience sharing seminars are also organised. Participation in international activities also improves the employees' knowledge substantially and provides information on best practices in auditing activities, whereas the provision of support to other supreme audit institutions aids the raising of the authority of State Audit Office staff among the supreme audit institutions of other countries.

Annual Report 2010

Annex 1. Budget of the State Audit Office

	Indicators	Execution in 2009 (LVL)	2010	
			Planned 2010 (LVL)	Execution 2010 (LVL)
1.	RESOURCES FOR COVERING EXPENSES:	3 303 542	2 668 111	2 672 573
1.1.	Subsidy from general revenue	3 283 519	2 642 381	2 642 381
1.2.	Foreign financial support	20 023	0	0
1.3.	Another own income	0	25 730	30 192
2.	EXPENSES (TOTAL):	3 125 713	2 668 111	2 442 062
2.1.	Maintenance expenses	3 124 314	2 650 111	2 424 211
2.1.1.	Remuneration	1 842 140	1 572 662	1 423 661
2.1.2.	State mandatory social insurance payments, social allowances and compensations	621 167	440 898	382 056
2.1.3.	Expenses for business trips	11 970	28 940	25 088
2.1.4.	Other maintenance expenses and operating costs related to ensuring operation of institution	628 197	606 411	529 589
2.1.5.	Expenses, covered by foreign financial support	20 023	0	0
2.1.6.	Subsidies and international cooperation (membership fees in public and international organisations)	817	1200	817
2.2.	Equity capital	1399	18 000	17 851
2.2.1.	Fixed assets	1092	8 852	8 703
2.2.2.	Intangible assets	307	9 148	9 148

Annual Report 2010

Annex 2.

Audits and compliance reviews conducted at the State Audit Office in 2010

No.	Name of internal audit, name of review	Internal audits, reviews conducted in the reporting year	
		Number of days	
		Scheduled	Actual
1	2	3	4
Internal audits in accordance with the annual plan			
1.	Monitoring of the progress of stocktaking for the reporting year	15	15
2.	Planning, implementation, control of the State Audit Office budget	40	33
3.	Organisation of human resource management activities	20	23
4.	International cooperation	30	30
5.	Recording and control of working time	20	20
Total		125	121
Compliance reviews			
1.	Planning and control of staff remuneration	5	5
2.	Legal assurance of the State Audit Office	5	5
3.	Circulation and protection of restricted access documents	80	75
Total		90	85