Special Report on the use of European Union financial support in Estonia in 2004–2006

Has Estonia succeeded in using the European Union financial support?

Special Report of the National Audit Office to the Riigikogu, Tallinn, 4 October 2007

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Summary

What have we done?

The NAO prepared a special report in order to get an overview of the use of financial support allocated to Estonia by the European Union. Its objective was to identify how the Estonian state has used the support and whether, on the basis of this, it could be assured to the European Commission that the implemented management and control systems are functioning and the EU financial support is being used in compliance with the established rules. The NAO considers it relevant to emphasize that this report is an overview, which points out the main problems in the field and does not provide an excessive amount of descriptive details.

In order to get an overview of how the EU financial support has been used in Estonia, you must visit several websites on the Internet, read a number of different reports and other documents and, to prevent misunderstanding, ask the officials for clarifications and specifications. But even that may not provide an overview. There are several reasons for that: documents have been written in a difficult language, there are many documents but there is no exhaustive list thereof, documents are specific and full of details, which confuse a layman and rather raise questions than provide answers.

The NAO did not get an overview of all the sums entirely received by Estonia from the European Union as, pursuant to the rules, a large number of supports are paid directly to the applicant who may not be a state authority, and in Estonia no centralised account is kept regarding those sums. Therefore, the report addresses the three largest financial supports paid to the Estonian state and whose use is planned in state strategies: support from Structural Funds and Cohesion Fund and support for the implementation of the European Union Common Agricultural Policy.

The preparation of the report was mostly based on publicly available materials (e.g., legislation, overview of foreign aid, monitoring reports, assessment reports, reports of the European Court of Auditors, auditing yearbooks of the European Union Structural Funds). In addition, a few audits carried out by the NAO. The NAO also asked the relevant authorities about their internal procedures and questioned the officials working in the field. The NAO did not carry out system audits or any other audits specifically for the special report, but relied on the work performed by the ministries and their divisions, monitoring committees and foreign assessors. All conclusions and observations given below rely on the abovementioned materials.

Upon drawing up the report, the NAO focused above all on the management and control systems of the use of support, reporting and on the planning of support in budgets and its actual use in 2004–2006.

Why is it important for taxpayers?

Proper implementation of management and control systems is important because the rules for the use of support have been laid down by the European Union and failure to comply with them can lead to the reclamation of support. Compared to compliance with formal criteria, the European Commission pays less attention to the attainment of objectives set by the support. Nevertheless, the Estonian state must observe both the compliance with the rules of use and attainment of desired objectives, so as to gain maximum benefit from the sum given to its disposal and avoid reclamation of supports. Or, in other words, these resources must be regarded as prudently as the money of the state's own taxpayers. That even more so, because the money paid from the European Union and the Estonian state's own budget funds are interconnected through the state's budget strategy.

In 2004–2006, Estonia had the opportunity of using a total of *ca* 20 billion kroons of financial support from the European Union funds. In the new financing period (2007–2013), this sum shall increase to *ca* 65 billion kroons. Co-financing by the Estonian state shall be added to these sums.

In order to ensure an effective and proper use of the EU support, an effective and functioning control system must be established. The Government of the Republic is accountable to the taxpayer in this regard.

The NAO draws attention to the fact that providing an overview for the public of the use of taxpayers' money, i.e., the use of the EU support is one of the fundamental principles of good governance. And this is the duty of the Government of the Republic.

What were our findings and conclusions?

According to the NAO, the Estonian state has succeeded overall in using the EU financial support in 2004-2006. Management and control systems for the processing of financial support have been established and these are in compliance with the European Commission requirements in the material part. However, there are several shortcomings in the management and control of the use of support and cost-effectiveness of the use of support is not being analysed sufficiently. This is indicated in the following observations and conclusions:

- The audits only assess the functioning of management and control systems and accuracy of expense receipts. They do not pay attention to whether the support is used pursuant to objectives and effectively. Similarly to the audits, monitoring and assessments focus above all on analysing the system and pointing out its problems. The NAO refers to the same problem in its wastewater audit.
- Indicators established for measuring the effectiveness of financed activities cannot always be measured or unambiguously interpreted.

- Approved projects contained shortcomings and were not entirely eligible.

- Confirmations provided to the management authority that the implementing agency has used the support of Structural Funds for eligible expenditure and purposefully are rather formal and not substantive (as the confirmation was mostly given without carrying out any activities).

- In the new financing period, a confirmation must be submitted to the Commission each year that the descriptions of management and control systems are in compliance with European Union legislation and in function, and that that the expenditure declared to the Commission is accurate and transactions they are based on, lawful. The NAO is of the opinion that this stresses the necessity to determine more clearly for those participating in the process the liability accompanying the implementation of support and check the compliance with established requirements.

- The Agricultural Registers and Information Board (ARIB) has not carried out checks regarding the discharge of functions delegated upon the implementation of the European Union Common Agricultural Policy, although this is required by a Regulation. According to the NAO, mere review and confirmation of the rules of procedure does not ensure the actual discharge of functions.

- A large number of errors identified in the use of support paid on the basis of Common Agricultural Policy refer to scant information provided to the applicants, which could be a result of the insufficient notification activities of the ARIB.

According to the NAO, management and control systems implemented for the planning and use of support should be supplemented, and the need for supplementation is the most urgent in the case of the agricultural refunds payment system.

- Several registers have been established for the payment of support and keeping account of its use, but at the same time, said registers have not been put to the best possible use and additional opportunities for the input and processing of information have not been created upon identifying shortcomings. This posed a problem for all supports.

  Databases play an important role in the system as their effective exploitation enables to strengthen management and control systems and plan inspections in a better manner, thus using time economically.

- The Ministry of Agriculture does not possess sufficient information to carry out supervision over the Agricultural Registers and Information Board as, pursuant to the current order, ARIB does not have to present the reports submitted to the European Commission (e.g., statement of expenditure, statement of non-compliance, etc.) also to the Ministry, neither for review nor for information.

- In most cases, required semi-annual reports on audits and implementation of proposals presented during said audits have not been submitted to the Ministry of Agriculture. Submitted reports differ by scope and thoroughness.

- Although the external auditor provides a confirmation on the accuracy of the annual report on agricultural support, it does not include the assessment on the purposeful use of support.

The actual use of the EU financial support envisaged in the State Budget has improved significantly over the years (on average, the use has increased from 53 % to 73 %). Compared to the use of the Estonia's own funds, which is at a level of 97 % on average, the activity of using European Union support is significantly lower – at 73 %. More attention must be paid to the improvement of the financial management in the field of using the support to use the available funds optimally and effectively. The need to improve the active use of funds is demonstrated by the fact that 1.4 billion kroons (or 7 %) of the amount allocated to us by the Commission remained unused at the end of 2006, which will increase the administrative burden at the beginning of the new financing period.

Current problems with administrative capacity have been as follows: poor planning of the budget, complicated rules of procedure, poor preparation of projects, insufficient consultation of applicants, and high staff turnover.

Reports submitted to the Government of the Republic and the Parliament for the performance of the management function and carrying out monitoring do not include all necessary information. For example, there is no overview of whether the planned objectives were attained with structural aids and agricultural refunds or what problems have been identified in relation to the payment of agricultural refunds.

The management and control system implemented in Estonia enables to submit to the European Commission a state declaration on the use of support from the Structural Funds and the Cohesion Fund. However, the current management and control system must be made more efficient. The management and control system of support paid on the basis of he Common Agricultural Policy, on the other hand, does not yet completely support the submission of state declaration.

At the same time, the NAO finds that if a Member State develops a commitment to submit a declaration to the European Commission on the purposeful and effective use of the funds, every state must have the right to implement such management and control systems that the respective state finds suitable for obtaining the desired confidence and taking responsibility. The role of the Commission in this matter should be more discreet.

Main recommendations of the NAO to the Minister of Finance:

- Assess more the cost-effectiveness of the use of support and attainment of objectives. Consider whether it would be necessary to require the internal auditors of implementing agencies and final beneficiaries to partly specialize in performance audits, so as to periodically assess the cost-effectiveness of the use of support.

- Lay down in legislation the mandatory content of reports submitted to the Government of the Republic on the use of the European Union support, and the frequency of submission of said reports. Tie management reports to strategic planning in a way that the state's management report would make clear how each ministry has used the EU support and which results have been achieved regarding strategic objectives.

- Consider submitting a state declaration to the European Commission on the fact that the management and control systems implemented in Estonia for Structural Funds and the Cohesion Fund are in function and said EU support has been used in compliance with the established rules.

- Maximise the use of the possibilities of the support database. If necessary, develop the database so that the structural aid register would record, among other things, the results of management and control system audits and information on shortcomings identified in the course of surveillance (incl. on-the-spot inspections) and on their removal.

- Improve the financial management in the field of using the support in order to use the European Union support funds optimally and effectively in the future. To improve administrative capacity, make use of the experience gained in the first financing period, preventing the occurrence of the same problems in the new period.

- Improve the internal audit system in a way that it would ensure the implementation of management and control systems, incl. the establishment of a legal framework necessary for the submission of confirmations, establishment of implemented control measures prior to submitting a confirmation.

Main recommendations of the NAO to the Minister of Agriculture:

- Organize an assessment of the efficiency of the use and attainment of the objectives of the support envisaged in the Rural Development Plan.

- Lay down in legislation the mandatory content of reports submitted to the Government of the Republic on the use of the support envisaged in the Rural Development Plan, and the frequency of submission of said reports.

- Establish a management and control system of financial support that would allow assuring the European Commission that support paid for the implementation of the Common Agricultural Policy has been used in accordance with the rules and purposefully.

- Ensure that the ARIB would use and develop databases created for getting an overview of the implementation of support. This would enable to systematically collect information on the implementation of support, analyse it in various ways and, as a result, strengthen the management and control systems and plan auditing operations in a better and more efficient manner.

- For the purpose of monitoring the activities of the ARIB, ensure the existence of sufficient information in the Ministry, requiring that copies of reports submitted by the ARIB to the European Commission should also be submitted to the Ministry for information or review, as necessary. Define the roles and responsibility of the Ministry and the ARIB in legislation.

- Harmonise the content and procedure for submission of the report submitted to the Ministry on the performed audits, imposing the duty of collecting information for the report and submitting it as a whole on the ARIB, who must possess information on problems identified during the course of the audits, due to its duties of a paying agency.

- Consider ordering from an external auditor an annual assessment on the purposeful use of support paid on the basis of the Common Agricultural Policy. This may also be carried out in the course of the annual report certification audit.

- Improve the internal control system, incl.

    - Ensure that the ARIB's internal auditors would perform random audits in control authorities in order to obtain confidence regarding the proper and substantive implementation of the delegated control activity; in control authorities that carry out control activities pursuant to their Statutes, establish a system of providing a confirmation on its activities to the paying agency.

    - Clarify the cause of the large number of errors discovered in the use of support and take measures to reduce said errors.

Replies from the Minister of Finance and Minister of Agriculture:

The Minister of Finance concurred with most of the NAO's recommendations. The Ministry of Finance has already implemented many of said recommendations on its own initiative, or plans to implement them in the future. Regarding the question of reports submitted to the Government of the Republic, the Ministry intends to cooperate with the Ministry of Agriculture.

The Minister of Agriculture concurred with half of the NAO's recommendations. As for the rest, the Minister found that the recommendations were not accurate or that there were no problems. One of the recommendations had already been implemented by the time the report was signed.

The NAO disagrees with the Minister of Agriculture. NAO's comments have been provided in the main body of text near the replies to the recommendations.

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European Union Financial Support to Estonia

1. The aim of this chapter is to describe two main areas funded by the general budget of the European Union – regional policy and Common Agricultural Policy, to explain the funding principles and supported areas of these policies. In addition, it provides an overview of the support allocated to Estonia in 2004-2006 and the preparations made for receiving the support. A brief description is also given of the preparations for the new financing period (2007-2013) and past developments in the financial management.

The main policy areas of the European Union

2. One of the tasks of the EU is to promote throughout the Community harmonious development of economic activities, continuous and balanced expansion, increase in stability, accelerated raising of the standard of living and closer relations between the Member States by establishing a common market and progressively approximating the economic policies of the Member States. The majority of the said objectives have been achieved through free movement of goods, persons, services and capital, ensuring fair competition and protection of the interest of the consumers.

Regional policy serves the objectives of reducing economic and social disparities in the level of development and achieving balanced development. Regional policy partially also concerns the integration, structural and competition policies.

Common Agricultural Policy serves the objectives of ensuring a stable supply of safe food for the population, providing a reasonable standard of living for the farmers, modernising and developing the agriculture industry, ensuring that all regions of the EU could sustain farming.

3. In order to enable all economic sectors in all regions of Europe to benefit from these achievements, EU finances the development of these sectors. The desire to reduce the gap between richer and poorer regions has led to the development of regional policy with annually increasing allocations for this policy from the EU general budget, amounting to 32 % of the total EU expenditures in 2006 and increasing to 36 % in the period 2007-2013. However, less than a half, or 45 %, of the EU expenditures are used for the implementation of the Common Agricultural Policy. The relative importance of the latter in the EU expenditures is gradually decreasing (reaching 34.9 % during the new period), because, on the one hand, agricultural reforms have resulted in cost-savings and, on the other hand, the other areas of activity of the EU have expanded. One could say from the budgetary point of view that the two most important EU policies are regional policy and Common Agricultural Policy.

Regional policy and Common Agricultural Policy support

4. **Regional policy** is the framework for financial support to disadvantaged regions and population groups: development of backward regions, redevelopment of old industrial complexes, facilitating employment of young people and long-term unemployed people, modernisation of agriculture and providing assistance to disadvantaged rural areas. Support is paid from different funds depending on established criteria or objectives: European Regional Development Fund (ERDF), European Social Fund (ESF), Financial Instrument for Fisheries Guidance (FIFG), and European Agricultural Guidance and Guarantee Fund (EAGGF Guidance Section). In addition to the said four funds, regional policy is also implemented through the Cohesion Fund (CF) that finances large-scale environmental and transport investments (projects with the cost of 10 million euro and above).

5. **Common agricultural policy** (hereinafter also referred to as 'CAP') is the framework for encouraging the farmers to implement production methods that do not pollute the environment and preserve the nature. The role of the rural population is to sustain a certain level of production in all regions and preserve the diversity of landscape in Europe. The CAP is implemented through direct aid, market support and export refunds, which are financed by the EAGGF Guidance Section.

Commentary by the Minister of Agriculture: We ask the NAO to make a differentiation in this paragraph and in the report in general between the CAP support for rural development and other support measures envisaged in the CAP (incl. market organisation support).

The objectives of the CAP have been specified in the EC Treaty – to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour; thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture; to stabilise markets; to assure the availability of supplies; to ensure that supplies reach consumers at reasonable prices. The 2003 reform of the Common Agricultural Policy supplemented this with further objectives – protection of the environment; food safety; animal health and welfare; greater market orientation.

Explanation of the NAO: NAO's Special Report is an overview report and this has been emphasised in the summary and description of the report. The report highlights the main problems in a field and does not delve excessively into descriptive details.

6. In the new financing period 2007-2013, the market organisation measures of the EU Common Agricultural Policy and fisheries are financed by the European Agricultural Guarantee Fund (EAGF) while agriculture and rural support measures are financed by the European Agricultural Fund for Rural Development (EARDF). Fisheries are supported by the European Fisheries Fund (EFF).

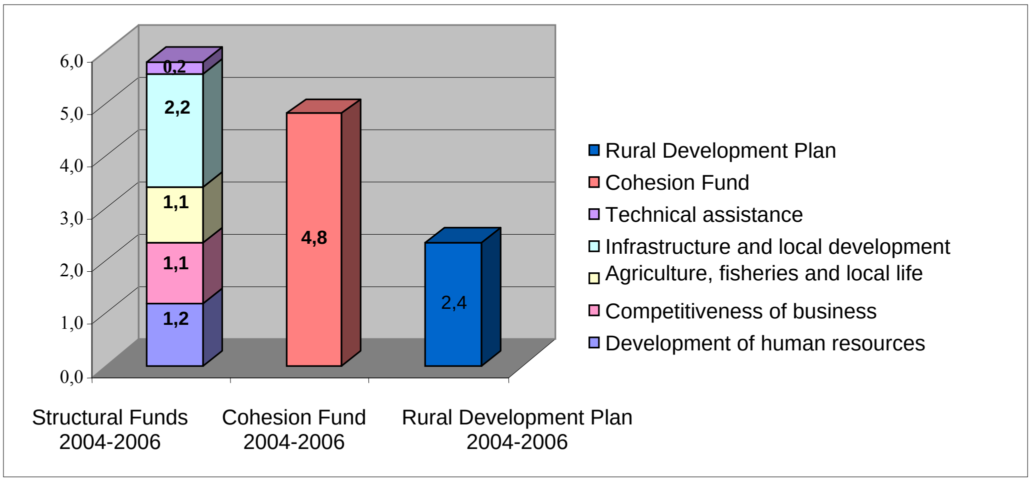
Support allocated to Estonia in Estonia's first programming period (2004-2006)

7. After accession to the EU on 1.05.2004, Estonia has the opportunity to participate in the implementation of the EU policy and, therefore, receive its share of the EU support. In order to receive and use this support, Estonia has to prepare relevant multi-annual programme documents and ensure the required administrative structures and procedures for proper implementation of the programme.

Structural Funds are the main financial sources for reducing the economic and social inequality between different EU regions.

8. The support allocated to Estonia in the first programming period in the framework of the EU regional policy is ca 10.6 billion kroons, including 5.8bn from the Structural Funds and 4.8bn from the Cohesion Fund (see Figure 1). While the distribution of support from the Cohesion Fund is based on the strategy documents in the field of the environment and transport, the support from the structural funds is used according to the Estonian National Development Plan for the Implementation of the EU Structural Funds: single programming document 2004-2006 (hereinafter also referred to as NDP). The main fields financed from the Structural Funds are infrastructure and local development (2.2bn EEK) and development of human resources (1.2bn EEK).

Figure 1. The amount of Structural Funds and rural development supports in 2004-2006 (bn EEK)



Source: National Audit Office on the basis of data from the Ministries of Finance and Agriculture

9. In the framework of CAP, Estonia has received in 2004-2006 more than 2.4bn kroons as support for rural development (see Figure 1). In order to implement the support, Estonia prepared the programme document Estonian Rural Development Plan 2004-2006 (hereinafter also 'Rural Development Plan' or RDP) that only concerns rural development support. Other support allocated in the framework of CAP (market support and export refunds) is allocated on the basis of applications and corresponding funding decisions. A programme document is not prepared and the amount is not agreed for this support. The market organisation support is funded 100 % by the EU general budget. In the field of rural development, the major areas of support have been agri-environmental support (887m EEK) and meeting standards support (437m EEK).

Key legislation governing the field

10. The principles of applying for and processing the applications for structural aid, the rights and obligations of the subjects associated with granting and using the support, and supervision procedures in Estonia for the period 2004-2006 were established with the Structural Assistance Act that entered into force on 1 January 2004.

11. The procedure for CAP implementation and implementing authorities, the principles of granting complementary national direct payments provided in the form of state aid, and the bases and extent of state supervision were established with the EU CAP Implementation Act that entered into force on 1 May 2004. Implementation of the European Fisheries Fund is regulated by the Fisheries Market Organisation Act. Various other national legal instruments that govern the use of EU support have been enacted on the basis of relevant legislation and European Commission regulations.

Accreditation and the start of submission of support applications

Accreditation – pursuant to the Structural Assistance Act means declaring the management and control systems of the intermediate bodies and final beneficiaries to conform to the requirements provided for in the EU legislation.

12. In 2004, when adopting the legislation that governs the use of support, the Estonian state decided to verify whether the relevant Estonian authorities are prepared for processing the applications and making the support payments in order to identify potential shortcomings before they start to process the support. The authorities responsible for Structural Funds and the Cohesion Fund were accredited by the Ministry of Finance and authorities responsible for CAP support were accredited by the Ministry of Agriculture.

13. During preliminary accreditation of the support measures for the implementation of the Common Agricultural Policy, the external auditor found significant flaws in the conclusion of written agreements (e.g., no agreements had been concluded with the warehouses, there were no established cooperation procedures between ARIB and the Tax and Customs Board); in addition, the requirements arising from the EU regulations had not been followed in the procedure rules and there were shortcomings in the documentation of irregularities.

14. The external auditor did not give a positive assessment of the preparation and compliance of the implementation system of ARIB, because all required audit procedures could not be completed. The internal auditors of the Ministry of Agriculture conducted two follow-up audits on the conformance of ARIB to accreditation conditions and they found that ARIB has taken the earlier recommendations into consideration and has improved its procedures, except for reporting in connection with documentation. In the assessment of the internal auditors, ARIB conformed to the requirements for accreditation of a paying agency in the audited extent.

Management and control system means an integrated set of measures to ensure reliable financial management of the Structural Funds, as well as purposeful and justified payment of support. The management and control system should ensure clear definition and division of tasks and application of the principle of separation of activities in the performance of the tasks.

15. The accreditation audits for Structural Funds and the Cohesion Fund began in October 2003 and had to be completed by May 2004. However, only around half of the accreditation audits were completed by this deadline and only five authorities of the total eighteen intermediate bodies and final beneficiaries had been audited. This situation was caused by the fact that it took the intermediate bodies and final beneficiaries longer than planned to set up their management and control systems.

16. The accreditation audits identified mainly shortcomings in legal framework (legal instruments and measure regulations had not been approved and were partially inaccurate), rules of procedure (these were missing or too general), and the statutes and job descriptions of the authorities (did not include the work areas and tasks deriving from the administration of Structural Funds). Prior to granting accreditation, the Ministry of Finance had to analyse whether the material shortcomings identified during the accreditation audit had been eliminated.

17. The first payment from the Structural Funds was made on 11.06.2004 (as technical assistance). The first support payment to an entrepreneur for investment in agricultural production was made on 23.07.2004. By the beginning of august, applications were being accepted for funding half of the measures and sub-measures specified in the NDP. In the case of funding rural development, four types of support were available as of 2004: less-favoured area supplements, agri-environmental support, semi-subsistent farm adaptation support, and meeting standards support.

Planning of support for the period 2007-2013

18. In the new financing period, Estonia will receive *ca* 53.3 billion EEK from the Structural Funds (incl. the Cohesion Fund) and 11.2 and 1.3 billion EEK of rural development and fisheries support, respectively (in the period 2007-2013, the rural development and fisheries support are no longer part of the structural aid). From the financial aspect, the main areas that will receive structural aid will include the development of the living environment (25bn EEK) and the economic environment (22bn EEK). The rural development strategy focuses on improving the competitiveness of agriculture and forestry; improving the environment and the quality of life; diversification of economic activity in rural areas.

Commentary by the Ministry of Agriculture: This is a somewhat imprecise interpretation of the objectives of the rural development strategy. The rural development strategy and the development plan are based on Council Regulation (EC) No 1698/2005, which states in Article 4 that support for rural development shall contribute to achieving the following objectives:

a) improving the competitiveness of agriculture and forestry;

b) improving the environment and the countryside;

c) improving the quality of life in rural areas and encouraging diversification of economic activity.

The above objectives shall be implemented by means of four axes (groups of measures contributing to the objectives).

The current wording of the report could lead to the conclusion that improving the environment and the quality of life are included in the rural development objectives/axes.

Explanation of the NAO: The purpose of the NAO special report is to provide an overview of the field, not a detailed description, and this has been emphasised both in the summary and description of the report. Therefore, the NAO does not discuss the so-called 'axes' in its report, but provides an overview of the principal directions of the rural development strategy. Such approach does not change the audit conclusions in any way.

19. While in the period 2004-2006 the use of the **EU regional policy aid** was regulated by national development plans and the use of the Cohesion Fund was regulated by the environmental and transport strategies, these will be replaced in the period 2007-2013 with an integrated national strategic framework instrument 'National Strategy for the Use of Structural Instruments 2007-2013', which is based on the national budget strategy for the period 2007-2010. Operational programmes have been developed in individual fields in addition to the strategy to specify the activities to be funded.

20. Internal negotiations were held in the spring 2006 in order to develop the strategy for the use of structural aid, where partners and other interest groups could submit their proposals for the first version of the draft. At total of 169 proposals and comments were received from 21 partners and around 60 % of them were taken into account in the course of planning by the ministries responsible.

Commentary by the Minister of Agriculture: In order to improve the understanding of the specifics of CAP and the associated rural development support, we propose to supplement this paragraph with the following sentence:

In the course of preparation of the Rural Development Plan 2007-2013, various partners submitted nearly 350 proposals of which more than 60 % were taken into account or partially taken into account.

Commentary by the NAO: The data referred to in the response of the Minister of Agriculture were not submitted to the NAO during the audit. As the correction is now included in the text as commentary by the Minister and this is not a major addition that would affect audit conclusions, the NAO did not consider it necessary to change the text.

Assessment was organised by the Tallinn University of Technology. The expert group for ex-ante assessment was chaired by Prof. Enn Listra, Dean of the School of Economics and Business Administration of the Tallinn University of Technology.

21. The expert group for ex-ante assessment of the National Strategy for the Use of Structural Instruments 2007-2013 and operational programmes gave a positive general assessment of the strategy and programmes. Among other things, the expert group made the following observations during the ex-ante assessment:

- The actions required for achieving the programme objectives need to be elaborated more clearly.
- The experiences gained in the last period (2004-2006) have been taken into account only to a limited extent.
- Links between strategy components are at a good level.
- Compliance of the strategy with distribution of funds and other regional, national and Community policies is not material but only declarative.
- The numeric indicators of strategy objectives cannot be assessed from the viewpoint of achievability.
- Weaknesses in the quality of the implementation system may significantly affect the achievement of strategy objectives.
- The analysis of the current situation does not indicate the extent to which Community priorities and the need to maximise the added value for the Community have been taken into account.

22. According to the Ministry of Finance, the proposals submitted have been implemented as far as possible.

23. The strategic instrument 'Estonian Rural Development Strategy 2007-2013' has been developed for distribution of **rural development aid** in the new period, and the programme document 'Estonian Rural Development Plan 2007-2013' has been developed on the basis of the strategy and approved by the Government of the Republic. The document approved by the Government of the Republic has been sent to the European Commission for approval.

24. In order to clarify the public interest, the Ministry of Agriculture consulted during the preparation of the development plan with the Agriculture and Rural Development Council and the Steering Committee established on 1 September 2005 for preparing the ERDP. Simultaneously with these joint meetings, regular work group meetings were held to devise measures of the RDP with contributions from various rural organisations, interest groups and experts in the field.

25. An ex-ante assessment of the Rural Development Plan was organised as well in order to assess the compliance of the plan with the needs and agreed objectives and to check the implementing procedures and conformance to CAP. The results of the assessment indicated that the current situation has been described in the development plan with a sufficient degree of thoroughness; the described measures significantly support achievement of the objectives, considering the limitation of the funds and critical needs of the target groups. However, it was recommended to specify the motivations of measures. It was also concluded that preparation of the Rural Development Plan has sufficiently considered the relevant Community objectives and the described monitoring system complies in general with the requirements of the Council Regulation. However, the assessor believed that monitoring and evaluation should be described in a more systematic manner.

Assessment was conducted by InterAct Projektid & Koolitus OÜ in cooperation with the Estonian University of Life Sciences and Audacon Eesti OÜ

26. In order to enable application for and distribution of the EU support in the new financing period, the Structural Assistance Act for the period 2007-2013 entered into force on 1 January 2007 and the previous Agricultural Policy Implementation Act was amended.

27. Unlike during the first Estonian financing period, only agencies acting as final beneficiaries are subject to accreditation in the new period. The accreditation is granted by the Government of the Republic following a proposal by the Ministry of Finance. The accreditation will also authorise the agency to act as a final beneficiary. If an agency fails to perform its duties in a proper manner, the Government of the Republic has the right to partial or full suspension of the authorisation.

New financial period – new set of financial rules

28. New programmes and rules will be implemented in the new financing period. The rules have been prepared by the European Commission and approved by the European Parliament and Member States. In the assessment of the Commission, the new financial rules will make the EU funds more transparent and simplify their implementation. The main changes are the following:

- **Simpler rules** – reduction of paperwork and simplification of procedures (both in the application for support and participation in procurements) will improve the accessibility of the EU funds for small and medium enterprises, schools, research centres and local governments.
- **Better public control** – the recipients of aid from the agricultural funds (as of budget year 2008) and Structural Funds (as of budget year 2007) will be disclosed in order to protect the financial interests of the EU. Disclosure of names and creation of a database where Member States enter institutions on the 'black list' can assist the Commission in preventing fraud and corruption. All institutions distributing the EU funds will have access to this database and the right to use the information contained therein. The Member States reporting system should be changed as well. The EU Member State agencies responsible for managing the use of the money received from the EU funds should ensure efficient operation of their internal audit systems and performance of the necessary audit procedures. Submission of respective annual reports by the Member States should give the Commission added confidence that the EU budget funds are used properly.

Standard internal audit principles

29. On 15.07.2005, the European Commission decided to amend the internal audit principles, increasing the responsibility of the Member States for the use of budget funds. The objective of standard internal audit is to receive a positive confirmation from the European Court of Auditors that transactions from the EU budget comply with the rules and are reliable. The main envisaged measures in this respect include the following:

- Simplify the established audit measures to reduce bureaucracy and costs and establish standard audit principles.
- National declarations of the Member States on the accuracy of the use of funds and opinions of highest audit bodies (such as the Estonian National Audit Office) on the Member State declaration to improve monitoring and control.
- Implementation of the single audit concept based on the so-called 'audit pyramid' to reduce the cost of auditing.

30. The proposal to establish the common internal audit framework was made by Siim Kallas (European Commission Vice-President for Administrative Affairs, Audit and Anti-Fraud), relying largely on the relevant proposals of the European Court of Auditors. The proposal is closely related to the fact that more than 70 % of the EU budget is spent in the Member States which is why the responsibility of the Member States for the performance of the established control systems and targeted use of the funds received should increase.

National declarations on the functioning of the system and lawful use of the funds

31. The Commission has made a proposal to the Member States to start submitting national declarations on the functioning of the control systems and proper use of the funds received. The content and submission procedures for this declaration have not yet been negotiated, but the Commission believes that the declaration should be approved by the highest audit body of the Member State. Confirmation of the Member State on the functioning of the system and lawful use of the funds would not affect the responsibility of the European Court of Auditors to assess the implementation of the EU budget. It would be only an additional confirmation to the Commission.

32. As the submission of the declaration is not yet mandatory, only two states – the Netherlands and Denmark – have partially followed the Commission's initiative.

33. In the Netherlands, the declaration is prepared by the Ministry of Finance and it is supplied with the opinion of the Netherlands Court of Audit. The declaration and the opinion are submitted first to the country's parliament and then to the European Commission. The 2007 declaration covers EU agricultural support, but in 2008 and after that it will cover all types of support payable from the EU budget under shared management. This declaration assesses:

- the structure of financial management in general, and
- compliance of transactions with rules and laws.

34. The National Audit Office of Denmark submits its opinion on the use of EU funds together with the assessment of the annual report of the state. In 2005, Denmark assessed the use and recognising of EU funds (incl. support received and granted) in the following manner:

- correctness of the annual report statements in general;
- regularity and lawfulness of transactions in general;
- structure and functioning of the agricultural support management and control system.

Denmark plans to continue providing this assessment, but the contents may be modified. The assessment of the use of funds in 2006 is expected by the end of 2007.

35. **The NAO is of the opinion** that the Estonian management and control system enables submission to the European Commission of a national declaration indicating whether support from Structural Funds and the Cohesion Fund has been used lawfully and the management and control systems are functioning well.

36. In the assessment of the NAO, submission of declarations is justified but each state should have the right to implement such management and control systems that it considers most appropriate for achieving the desired level of confidence and taking responsibility. The role of the Commission in this matter should be more discreet.

37. **Recommendation of the NAO to the Minister of Finance:** Consider submitting a state declaration to the European Commission on the fact that the management and control systems implemented in Estonia for Structural Funds and the Cohesion Fund are in function and said EU support has been used in compliance with the established rules.

Response of the Minister of Finance: In the beginning of 2010 at the latest, the audit authority will submit to the European Commission a statement on winding-up of financial support for the period 2004-2006 and it will include an assessment of the entire period and each individual fund. The conducted management and control system audits have assessed whether the implemented management and control systems are in function and the EU support has been used in compliance with the established rules. Respective system audits have been conducted at least once in three years in each agency and the annual summary (conclusion) has been included in the Annual Report on Structural Funds Auditing.

Pursuant to Article 62 of the Council Regulation No 1083/2007, the audit authorities of all Member States are required in the period 2007–2013 to submit to the Commission a summary report on the findings of completed audits and an opinion as to whether the management and control system functions effectively, so as to provide reasonable assurance that statements of expenditure presented to the Commission are correct and the underlying transactions are legal and regular. It means that in the new programming period, submission of the annual opinion to the European Commission is the responsibility of the audit authority. Preparations to develop a methodology for this confirmation have been already started. When developing the methodology, the Ministry of Finance will also analyse whether submission of a declaration in a similar form would be justified and possible before closing the programming period 2004–2006.

We agree that structuring the internal assessment process is a task that involves much responsibility and requires many resources. It implies good cooperation between various parties in order for the national declaration to provide maximum benefit for the Commission and Court of Auditors and to achieve the objective stated by Siim Kallas, Vice-President of the Commission, that the Court of Auditors would be able to approve the EU budget without reservations.

Management and Control of the Use of the European Union Financial Support in Estonia

38. The objective of this chapter is to provide an overview of the management and control systems implemented in Estonia for the payment of support from the Structural Funds, Cohesion Fund and Common Agricultural Policy. This and the following chapter describe the system and use of CAP support in a general manner (without unnecessary details). More attention is paid to the support payable under the Rural Development Plan, because the use of this support is governed by the plan (RDP) that specifies the fields to be developed and objectives to be achieved. The chapter also includes a description of the organisation of the protection of the EU financial interests in Estonia and reporting to the Government of the Republic and the Parliament. In addition, the NAO has made recommendations to improve the system.

Management and control of the use of Structural Funds

Management system for the use of support

39. In order to implement the national development plan, a public structure was established in Estonia pursuant to the Structural Assistance Act for the period 2004–2006, including a managing authority, paying authority, auditing authority, intermediate bodies and final beneficiaries. In addition, a state register of structural assistance was established to keep records on the granting and use of the assistance. Daily monitoring is used to verify that the management structures for the use of Structural Funds are in function, the results and objectives are achieved, and the funds are used lawfully. The use of financial assistance is monitored through the register, steering committees, monitoring committee and monitoring reports.

40. **The managing authority** manages the activities associated with the preparations for, planning, implementation, monitoring, evaluation, supervision and disclosure of the use of the Structural Funds. Estonia has one managing authority and its functions are carried out by the Ministry of Finance.

41. **The paying authority** is responsible for ensuring proper management of the use of funds as well as for targeted use of the assistance and eligibility of expenditures. For that purpose, the paying authority applies for funds from the Commission, ensures payments, verifies to certain extent the eligibility of expenditures, regularity of payments, etc. In addition, the paying authority is required to repay to the

Commission all irregular expenditures. There is one paying authority as well and its functions are carried out by the Ministry of Finance.

42. **The intermediate body** is responsible for planning the support, strategic planning, monitoring, advising the final beneficiaries, carrying out supervision of the final beneficiaries, etc. The intermediate bodies can be responsible for a priority or for a measure. There are eight intermediate bodies in total and they are the ministries and the State Chancellery (see Annex 1).

43. **The final beneficiary** performs the functions relating to the implementation of the projects. This could include, for example, processing of project applications, adopting of decisions on granting the support, submission of payment orders to the paying authority (incl. verification of expenditure documents), collection of data required for monitoring, and carrying out supervision over the final recipient. In addition the final beneficiary is responsible for the repayment of irregular expenditures to the Commission. There are thirteen final beneficiaries and these include both state agencies and foundations (see Annex 1).

44. **The auditing authority** is responsible for organising the audits prescribed by the EU legislation and confirming regular use of the expenditures upon expiry of the period of financial assistance from the Structural Funds.

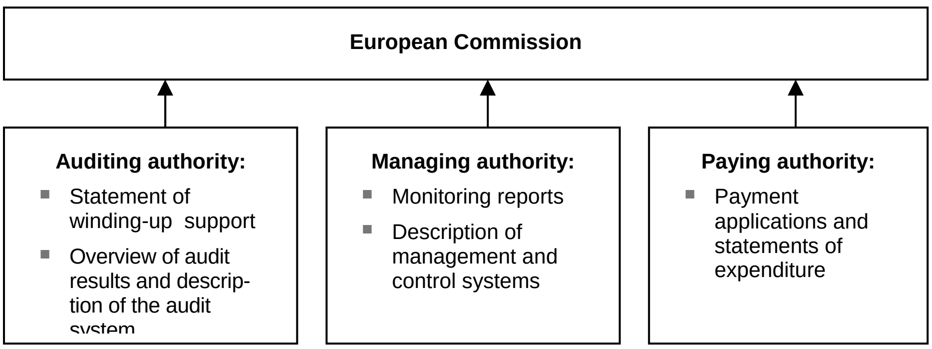
Steering ministries – Ministry of Education and Research, Ministry of the Environment, Ministry of Economic Affairs and Communications Their role is to monitor the implementation of the operational programmes in the new period.

45. **In the new financing period**, the management system will remain largely the same as in the first financing period. Unlike in the previous period, some intermediate bodies will now also perform the functions of the steering ministry of the operational programmes, being responsible for the development and implementation of operational programmes. The intermediate bodies and final beneficiaries for each operational programme are listed in Annex 2.

Reporting to the European Commission

46. Reporting to the Commission takes place through several authorities and submission of various reports. The authorities and reports involved are shown on Figure 2.

Figure 2. Reporting to the European Commission



Source: National Audit Office on the basis of data from the Ministry of Finance

47. Before the transfer of the last amount of the financial assistance from the European Commission to the Member State, the auditing authority should prepare and submit a declaration on winding-up the use of structural assistance for each Structural Fund (see Figure 2). This is to confirm that the expenditure declaration of the paying authority is accurate and the underlying transactions are legal and regular. As the implementation of the NDP is still unfinished and no final payments have had to be made, the respective declarations on winding-up have not yet been prepared.

48. In addition to the said declaration, the auditing authority is required to submit to the Commission annually by 30 June a description of the national procedures for auditing the support and an overview of the audit findings in the previous period, providing a summary assessment of the functioning of the management and control systems. A description of the management and control systems, prepared by the managing authority, is submitted to the Commission together with the said overview (see Figure 2).

49. Applications for funding from the Structural Funds are submitted through the paying authority that is required to submit reports to the Commission. The paying authority submits to the Commission a statement of expenditure and payment application, which also serve to confirm that the support has been used regularly and payments have been made to cover eligible expenditures (see Figure 2).

50. In order for the paying authority to be able to confirm eligibility and regular use of the expenditures, a procedure for confirming the eligibility of payments has been established in Estonia (see Figure 3). The managing authority bases its confirmation on the confirmations of the intermediate bodies on the regularity of the use of the support and eligibility of expenditures.

51. The respective report formats for the managing authority, intermediate body and final beneficiary to confirm the regularity of support and eligibility of expenditures have been established by the Minister of Finance Regulation No 29 of 8.03.2004 on "The Procedure for Financial Reporting on the Use of Assistance"[1]. Neither this Regulation nor any other regulation include the requirement to carry out the necessary control procedures before giving the confirmation.

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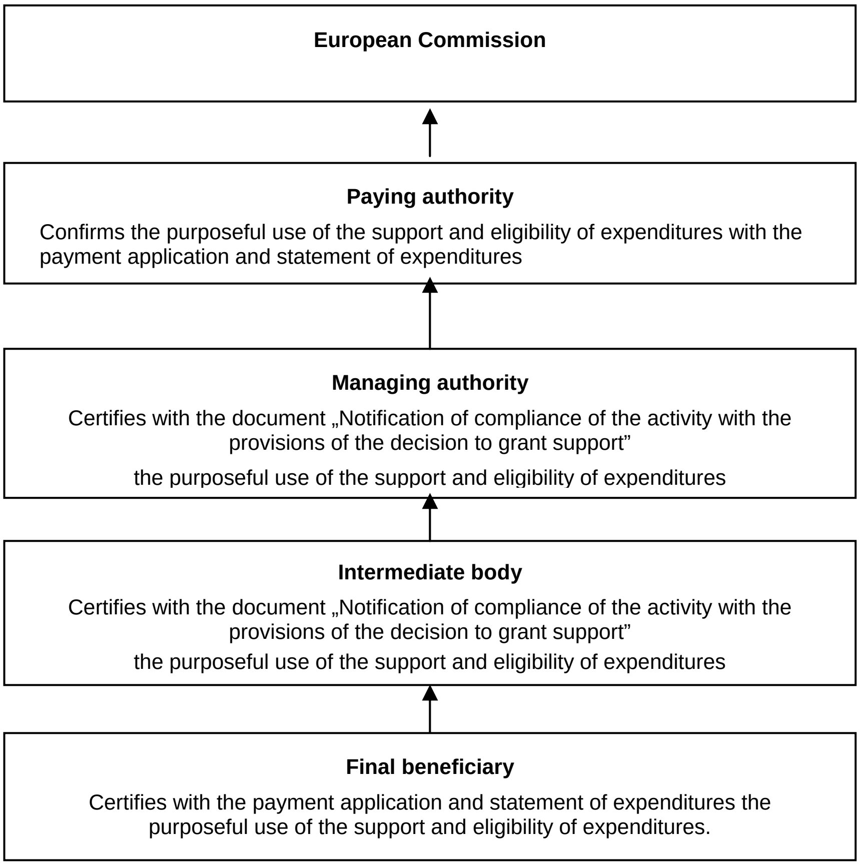
[1] As of 2 April 2007, the Government of the Republic Regulation No 22 on 'Procedure for Submission of Financial Reports on the Payment and Use of the Structural Assistance in the Period 2004-2006, and Reporting Formats'

Figure 3. Confirmation of the regularity of payments (2004–2006)



Source: National Audit Office on the basis of data from the Ministry of Finance

52. According to the explanations by the Ministry of Finance, the control procedures to be carried out before giving written confirmation have been established in the rules of procedure of the managing authority, intermediate body and final beneficiary.

53. Shortcomings associated with the confirmations have been also referred to in the report of the evaluator (AS PricewaterhouseCoopers). The interviews indicated that the majority of the intermediate bodies do not perform any actions for issuing the confirmation, with the exception of the Ministry of the Environment that fills out a brief and superficial checklist prior to issuing the confirmation and the Ministry of Economic Affairs and Communications that requests a similar confirmation from the Enterprise Estonia, even though such obligation is not established by the Regulation of the Minister of Finance. Furthermore, until the beginning of 2006, the managing authority did not have any procedure specifying the required actions prior to issuing the statement. By the time of completion of the evaluation report, the managing authority had developed and partially implemented the respective procedure.

54. **In the new financing period,** the procedures for issuing confirmations remain generally the same. In addition to confirming eligibility of expenditures and regular use of support, the parties will submit to the paying authority confirmations that the management and control systems are in function.

55. **The NAO is of the opinion** that creation of a proper system for issuing the confirmations, incl. the required control system, in the country is important. The main reason is that it would enable the Ministry of Finance to rely on the confirmations received from the subordinate authorities in the established management and control system when performing its reporting duties. On the other hand, it is also important that the necessity of issuing the said confirmations would be understood and the confirmations would be well considered not simply formal declarations. The NAO believes that the current system enables to approach the confirmation as if it were a purely formal procedure.

56. **Recommendation of the NAO to the Minister of Finance:** Establish a legal framework necessary for issuing confirmations and establish control measures to be implemented prior to submitting the confirmation. This would also require an analysis, whether the system of issuing confirmations needs improvement.

Response of the Minister of Finance: We would like to point out that, in addition to the confirmations issued by the auditing authority that have been discussed under item 1 of this response, there are currently additional mechanisms for gaining assurance that the granting and use of the support is adequate. A separate procedure has been established by the Ministry of Finance Regulation in order to gain assurance of the eligibility of stated expenditures and functioning of the management and control systems. "In the beginning of 2010 at the latest, the auditing authority will submit to the European Commission a statement on winding-up of financial support for the period 2004-2006 and it will include an assessment of the entire period and each individual fund. The conducted management and control system audits have assessed whether the implemented management and control systems are in function and the EU support has been used in compliance with the established rules. Respective system audits have been conducted at least once in three years in each agency and the annual summary (conclusion) has been included in the Annual Report on Structural Funds Auditing.

Pursuant to Article 62 of the Council Regulation No 1083/2007, the auditing authorities of all Member States are required in the period 2007-2013 to submit to the Commission a summary report on the findings of completed audits and an opinion as to whether the management and control system functions effectively, so as to provide reasonable assurance that statements of expenditure presented to the Commission are correct and the underlying transactions are legal and regular. It means that in the new programming period, submission of the annual opinion to the European Commission is the responsibility of the audit authority. Preparations to develop a methodology for this confirmation have been already started. When developing the methodology, the Ministry of Finance will also analyse whether submission of a declaration in a similar form would be justified and possible before closing the programming period 2004-2006.

We agree that structuring the internal assessment process is a task that involves much responsibility and requires many resources. It implies good cooperation between various parties in order for the national declaration to provide maximum benefit for the Commission and Court of Auditors and to achieve the objective stated by Siim Kallas, Vice-

President of the Commission, that the Court of Auditors would be able to approve the EU budget without reservations." (The latest version is dated 2 April 2007). Consequently, the required legal framework for confirming the eligibility, incl. regularity, of the expenditures already exists (a similar procedure has been also established for the period 2007-2013). According to this procedure, assurance that expenditures are eligible is gained and confirmed in stages at each level of the implementing system, from the level of the final beneficiary through the intermediate body and managing authority to the paying authority. The final confirmation to the European Commission is issued by the paying authority. The control procedures with regard to expenditures as well as the management and control systems are carried out at each level according to the respective competencies and responsibilities.

In order to simplify the procedure of confirmation, the format of the confirmation ('statement') was changed in April 2007 so that it would include the basic checklist for each authority. This specifies the exact procedures for which the confirmation of performance and appropriateness is required. The logic of procedure dictates that, when issuing confirmations, the authorities have to rely mainly on their regular control procedures. At the level of final beneficiaries, the Ministry of Finance has been issuing respective instruction materials already since 2003. In order to harmonise the procedures for issuing and recording confirmations of the intermediate bodies, the Ministry of Finance issued on 25 June guidelines for the intermediate bodies for the organisation of supervision over final beneficiaries.

Commentary by the NAO: The NAO in its recommendation considered the objective that issuing the confirmation should not be approached as a formal procedure and that specific prior control procedures should be established. If no other means suffice, the procedure for issuing confirmations should be established by a Government of the Republic Regulation. The NAO believes that if the established new procedure takes account of the above considerations, the main shortcomings have been eliminated.

Control system of the use of support

57. The main structural assistance control measures include accreditation, monitoring, evaluation, supervision and auditing. A control chart (auditing, supervision and monitoring) is provided in Annex 3.

Monitoring the use of support

58. The objective of monitoring is to observe the implementation and efficiency of support. Monitoring is performed by the intermediate bodies and final beneficiaries, according to their respective competencies, under the management of the managing authority. Monitoring is performed at the levels of measure, priority and development plan. The NDP monitoring report is submitted to the monitoring committee for approval. The managing authority then submits the approved report to the European Commission for endorsement (see Figure 2). The Commission uses the monitoring report to assess the sufficiency of measures applied for the implementation of the development plan.

59. The managing authority has forwarded to the European Commission the monitoring reports for 2004 and 2005 and they have been endorsed by the Commission. The 2006 report has been submitted to the Commission but no final opinion has been received yet.

60. While there was only one NDP monitoring committee in the first Estonian financing period, there will now be three monitoring committees in the **new financing period** – a separate committee to monitor each operational programme. The work of the monitoring committees will be managed by steering ministries responsible for the preparation of the operational programme monitoring reports. Like in the first period, any proposals for the amendment of an operational programme should be submitted to the Commission for endorsement after they have been approved by the monitoring committee and the Government of the Republic.

Evaluating the use of support

61. Evaluation of the implementation of operational programmes and the associated monitoring procedures through an analysis of the results and impact enables to get an independent and integrated assessment of the degree of success achieved in implementing the support programme. Evaluation helps to develop recommendations for improving the implementation of the operational programme and achieving the established goals.

62. The managing authority is responsible for organising the evaluations of the NDP. The managing authority supervises the creation of an evaluation schedule, which is then approved by the monitoring committee. Implementation of the recommendations made during evaluation is the responsibility of the bodies ordering the evaluation and this could mean in addition to the managing authority also the intermediate bodies or final beneficiaries.

63. An ex-ante evaluation of the NDP and 10 additional evaluations had been ordered by 31.12.2006. The additional evaluations have been performed mostly by external experts, such as PricewaterhouseCoopers AS, Ernst&Young Baltic AS and CyclePlan OÜ, who have won the tenders. The main results of evaluation have been highlighted in items 195-205.

64. **In the new financing period,** evaluations of the operational programmes will be organised by the intermediate bodies and final beneficiaries. The managing authority will remain responsible for the evaluation of the strategy of the use of structural assistance. Like in the previous financing period, the managing authority will remain responsible for the Estonian coordination of the ex-post evaluations organised by the European Commission.

Supervision of granting and use of the support

65. The purpose of supervision is to verify the purposeful and lawful grant and use of the assistance. The system of supervision is based on a multi-level structure.

66. The intermediate body as the agency positioned above the final beneficiary in the management structure carries out supervision over the final beneficiary. In the course of supervision, the supervisory official of the intermediate body has the right to inspect information relating to the grant of assistance, perform on-site inspections and monitor the activities of the final beneficiary upon the exercise of supervision over the final recipient.

Penalty payment – a determined amount payable by a person if the person fails to perform the obligation imposed by a precept during the term indicated in the warning.

67. The final beneficiary exercises supervision over the activities of the final recipient. In the course of supervision, the supervisory official has the right to inspect information and documents relating to the use of assistance, examine the objects created using the assistance, and conduct on-the-spot visits. The supervisory official has the right to issue precepts on violations relating to the use of assistance and impose a penalty payment if necessary.

68. In addition to the intermediate body, the activities of the final beneficiary are supervised by the paying authority. The paying authority verifies that the payment application submitted by the final beneficiary is drawn up accurately and the description of expenditure on the payment application meets the eligibility criteria. In the case of suspicion, the paying authority may conduct on-the-spot inspections.

Auditing the use of support

69. Unlike in the first Estonian financing period, the paying authority no longer verifies all payment applications submitted by the final beneficiaries in the new period, but instead uses a special methodology to carry out random checks.

Audit of the management and control systems consists of verification and analysis of the effectiveness of the management and control systems of the persons involved in granting and using assistance.

Audit of the expense receipts consists of verification of at least 5 % of all actual eligible expenditures paid by the time of the final payment.

70. The purpose of the audits is to establish that the support paid from the Structural Funds has been used purposefully and in compliance with the EU laws. This activity is the responsibility of the auditing authority that conducts the audits of management and control systems and the audits of the expense receipts in cooperation with the internal auditors of the intermediate bodies and final beneficiaries and reports the finding to the Commission (see Figure 2).

71. Unlike the audits of expense receipts, the reports on the management and control system audits conducted in the intermediate bodies and final beneficiaries are not entered in the register of structural assistance. The reason for this is that the register has been developed as a project management system where data are registered separately for individual projects. As the audits of management and control systems are not related to a specific project and the reports are not entered in the register, there is still no opportunity to register this information separately for individual intermediate bodies and final beneficiaries.

72. **Recommendation of the NAO to the Minister of Finance:** Ensure recording the audits of the management and control systems in the register of structural assistance. This change would enable to save time and conduct a systematic analysis of all information.

Response of the Minister of Finance: It is true that the reports and data of the management and control system audits are not included in the register of structural assistance. This register is a project management system where all data have been entered by individual projects and the purpose of the register is to facilitate project management and preparation of reports and statistical data for the projects. As the management and control system audits are not related to specific projects, the information obtained from these audits cannot be recorded in the register.

This does not mean that there is no overview of the management and control system audits. All management and control system audits are registered in the audit plan prepared by the auditing authority and audit reports are given to the audited body itself, as well as the auditing authority and the managing authority. The reports of the management and control system audits can be classified by the intermediate bodies and final beneficiaries, because each audit report is associated with a specific audited body. The Ministry of Finance (managing authority) also systematically verifies the implementation of the recommendations made in the course of the management and control system audits and, consequently, has a good overview of the elimination of shortcomings. It should be also said that the number of the audits of the management and control systems cannot be large (compared to the number of audits at the level of projects) and this is the reason why it would not be economically feasible to register them in a separate information system or to develop a separate audit report management module in the register of structural assistance.

73. While in the first Estonian financing period the internal auditors of the intermediate bodies and final beneficiaries as well as the auditing authority had to conduct the management and control system audits and expense receipt audits, the internal auditors no longer have this obligation in the **new financing period**. The audits conducted during Estonia's first financing period do not provide an assessment whether the support was used for the intended purpose and in a cost-effective manner. The NAO believes that the reduced workload of the internal auditors would enable them in the future to specialise on assessing the cost-effectiveness and impact, which is currently not sufficiently done (particularly in the case of the Cohesion Fund, see item 94).

74. **Recommendation of the NAO to the Minister of Finance:** Assess more the cost-effectiveness of the use of support and attainment of objectives. Consider whether it would be necessary to require the internal auditors of intermediate bodies and final beneficiaries to partly specialize in performance audits, so as to periodically assess the cost-effectiveness of the use of support.

Response of the Minister of Finance: Structural assistance has been available in Estonia since spring 2004, i.e., slightly longer than for three years. As Estonia acceded to the European Union in the middle of the programming period (the programming period itself lasts for seven years, i.e., 2000–2006) and mid-term appraisal of the programmes had already been completed in Europe, there were no mid-term objectives established for the use of structural instruments. Pursuant to the Regulation laying down general provisions on the Structural Funds (Council Regulation No 1260/1999), the Member States may use the structural instruments for up to two years after expiry of the programming period, i.e., until the end of 2008 in the case of the period 2000-2006. As support payments can be made until the end of 2008, the final assessment of the achievement of objectives and performance could not be made before that time. Therefore, the number and extent of studies and evaluations directed at measuring performance has been moderate so far, but some such studies and evaluations are conducted as an input in the planning for the period 2007-2013 and some performance evaluations are conducted routinely. For example, the State Chancellery has already conducted a performance and impact assessment of the NDP measure 1.4 'Enhancing Administrative Capacity', there has been some assessment of the impact of investments on Estonian fisheries, and a study of the results of the measure 1.3 'Inclusive Labour Market' organised by the Ministry of

Social Affairs is currently underway. The Enterprise Estonia has organised an assessment of the impact of enterprise support measures and continues follow-up evaluation of the setting-up aid, which includes questioning all recipients of the setting-up aid three times within three years after they received the aid. Furthermore, many measures require follow-up reports on the long-term results of the projects and they are used for regular analysis.

However, we share the opinion of the NAO that the evaluations and studies of the performance will become increasingly topical over the next two years.

We would also like to point out that the audit function currently already support measuring the performance. The performance of using the support is evaluated in the current period in the course of the audits of expense receipts pursuant to the guidelines of the European Commission and the methodology prepared by the auditing authority, and it will be audited in the new period also as part of project audits. Based on the fact that the use of support is sufficiently covered with audit procedures arising from the EU and domestic legislative requirements that also include evaluation of cost-effectiveness, the auditing authority does not see a need to impose on the internal auditors of intermediate bodies and final beneficiaries the obligation of conducting performance audits. The internal auditors have the opportunity to add performance audits to their work schedules according to the results of risk assessment. For the period 2007-2013, the auditing authority will submit to the Commission an audit strategy within nine months after approval of the operational programmes and it will specify the sampling methodology and an initial auditing plan. The internal auditors are not under the obligation to audit structural assistance in the period 2007-2013. The auditing authority will prepare a structural assistance work schedule in each year and the internal auditors will be involved in this process.

75. **While in the first financing period** the internal auditors of the intermediate bodies and final beneficiaries were involved in conducting the audits alongside the auditing authority, only the auditing authority will have the obligation to conduct the audits required by the EU legislation and report the findings in the new period.

76. In the new period, the auditing authority is additionally required to submit an annual confirmation to the Commission stating that

- the descriptions of the management and control systems in the operational programmes comply with the EU legislation;
- the management and control systems are functional and, consequently, any expenditures declared to the Commission are accurate and the underlying transactions are lawful.

77. **The NAO is of the opinion** that this requirement creates a need to determine more clearly for those participating in the process the liability accompanying the implementation of support and check the compliance with established requirements. This also means a review and enhancement of the confirmation system described in items 50-54.

Management of the use of the Cohesion Fund and reporting to the European Commission

Management and control of the use of the Cohesion Fund

78. The management system of the Cohesion Fund is similar to that of the Structural Funds. The main difference concerns the number of authorities involved in distributing the Cohesion Fund support and the method of distribution of funds. While the money from the Structural Funds is allocated to the Member State on the basis of the NDP, the support from the Cohesion Fund is allocated for individual projects. It means that the Member State submits project applications for the Cohesion Fund to the Commission and the Commission makes the funding decision.

79. Like with the Structural Funds, application for and control of the use of support from the Cohesion Fund is organised by the managing authority, paying authority and auditing authority and these functions are also performed by the Ministry of Finance.

80. The managing authority is responsible for establishing the management and control systems, verifies compliance of project applications and then forwards them to the Commission.

81. The intermediate body is responsible for accurate and proper administrative management and supervision of the projects, and regular use of the support. The main tasks of the intermediate body include preparation of the plans for the implementation of the Cohesion Fund, reception of project applications, conclusion of contracts with final recipients, and verification of the expenditure report and payment application to be submitted to the Commission on the basis of the payment application.

82. The final beneficiary is responsible for the eligibility of expenditures. The main tasks of the final beneficiary include verification of project applications, submission of payment applications to the paying authority, collection of information required monitoring, and supervision over the final recipient.

83. In contrast to the Structural Funds, there are only two intermediate bodies in the case of the Cohesion Fund: the Ministry of Economic Affairs and Communications and the Ministry of the Environment, and five final beneficiaries: Environmental Investment Centre, Road Administration, Railway Inspectorate, Maritime Administration and AS Tallinna Lennujaam.

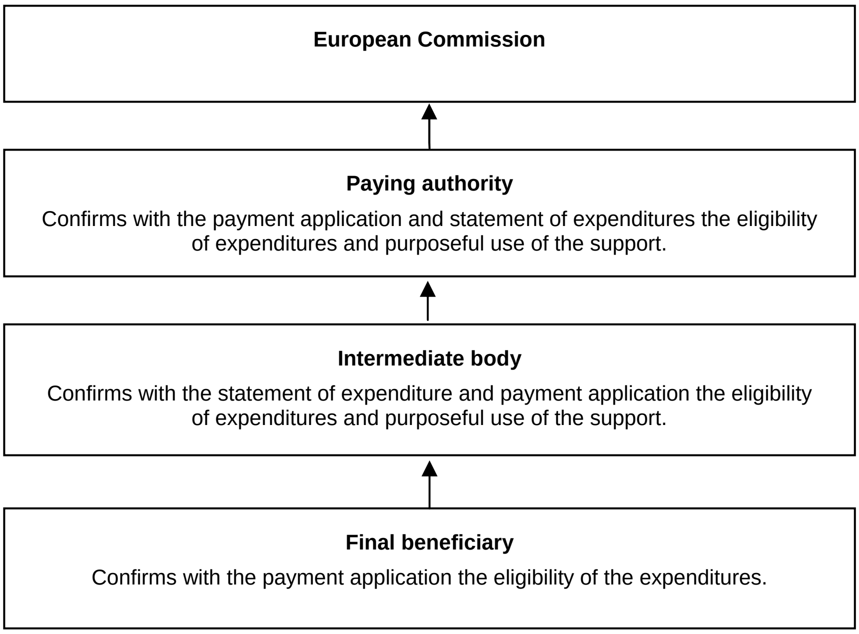
84. Unlike with the Structural Funds, an electronic information system was not used to collect information on the allocation and use of the support from the Cohesion Fund. According to the Ministry of Finance, an electronic register was completed in the autumn 2006 but it has not been implemented, because it is not user-friendly.

85. The reporting to the Commission on the support received from the Cohesion Fund in the first financing period was slightly different that reporting on the support from the Structural Funds. While in the case of the Structural Funds the auditing authority is required to issue a confirmation upon winding-up of each Structural Fund, the Cohesion Fund procedures require the auditing authority to prepare a statement of winding-up the support for each project. In addition, the audited expenditures prior to the final support payment should amount to at least 15 % of all actually paid eligible expenditures.

86. Similarly to the Structural Funds, application for funding from the Cohesion Fund goes through the paying authority that is subjet to reporting to the Commission. The paying authority submits to the Commission a statement of expenditure and payment application, which also serve to confirm that the support has been used regularly and payments have been made to cover eligible expenditures.

87. The national procedure for issuing confirmations is slightly different in the case of the Cohesion Fund from that used for the Structural Funds. Namely, the payment authority does not receive the confirmation from the managing authority but the intermediate body (see Figure 4).

Figure 4. Issuing confirmation of the regularity of CF payments (2004–2006)



Source: National Audit Office

88. As was the case with the Structural Funds, neither the Minister of Finance Regulation nor any other document specifies the control procedures required before issuing a Cohesion Fund payment confirmation. According to the explanation by the Ministry of Economic Affairs and Communications, such control procedures are, however, carried out. (See also item 53)

Major projects – investment projects with a total cost exceeding 25m EUR in the case of environmental projects or 50m EUR in the case of other projects.

89. In the new financing period, the applications for major projects will be submitted to the Commission by the intermediate body. In the case of projects with the cost below the major project limit, the funding decisions will be made by the intermediate body itself.

90. In the new period, the support from the Cohesion Fund is granted on the basis of the operational programmes shared with the Structural Funds, which makes the structure of the management and control systems similar to that of the Structural Funds. In addition, the Ministry of Finance has stated that the use of the support from the Cohesion Fund will be recorded in the register of structural assistance.

91. Reporting and confirmation procedures relating to the purposeful use of the Cohesion Fund, eligibility of expenditures and functioning of the management and control systems in the new period will be similar to those applicable for the Structural Funds (see items 50-54).

Controlling the use of support

92. As the Cohesion Fund deals with high-cost projects, the final recipients of this support should pass, in addition to the control measures applicable to the implementation of the Structural Funds, also a preliminary procurement control in order to coordinate procurement documents with the intermediate body and final beneficiary.

93. While the NDP monitoring report is prepared once a year for the Structural Funds, it is prepared twice a year for the Cohesion Fund. The monitoring reports are prepared for each project and they are collected into a monitoring report on the implementation of the Cohesion Fund projects, which provides a summary overview of the current status and general progress of all projects.

94. Evaluations of the Cohesion Fund projects may be ordered both by the managing authority and the European Commission. Even though six investment projects had been completed as on 31.12.2006, including four in the environmental (mainly water and wastewater treatment systems, waste management, etc.) and two in the transport (road reconstruction) sector, no evaluations have been initiated so far for any of the projects. (See also items 73-74)

95. According to the explanations of the Ministry of Finance, there are plans to simplify the preliminary procurement control system in the new financing period and omit the preliminary control function if possible.

Management and control of the use of agricultural support

Management system for the support payable under the Common Agricultural Policy

96. The management and control system of the CAP differs significantly from those of the Structural Funds and the Cohesion Fund. The structure established for the implementation of CAP consists of a managing authority, paying agency and certifying body. In terms of the Structural Funds, the paying agency performs the functions of the intermediate body, final beneficiary and paying authority. Records on the grant and use of the support are kept in four main information systems. Daily monitoring of the use of CAP support takes place through information systems, monitoring work group and committee, and monitoring reports. The monitoring committee assesses the development of the Rural Development Plan and makes proposals to increase the efficiency of its implementation.

Commentary by the Minister of Agriculture: I do not agree with the assessment of the NAO that the paying agency performs the functions of the intermediate body in terms of the Structural Funds. Some functions of the intermediate body in terms of the Structural Funds (such as development of measures, development of project selection criteria, etc.) are performed by the managing authority.

The monitoring reporting in the described form is not done in case of CAP support measures.

We would also like to ask the NAO to specify what they mean by a 'monitoring work group'. According to the RDP, a monitoring group should be established for the agri-environmental support. The functions of this work group have been performed by the Agri-environmental Monitoring Group.

Explanation of the NAO: The NAO emphasizes that this report is an overview, which points out the main problems in the field and does not provide an excessive amount of descriptive details.

The letter of the Minister of Agriculture does not describe the procedures used to prepare the monitoring report. The NAO does not understand the Minister's comments about the monitoring. Item 100 of the Special Report states that monitoring and evaluation concern only one part of CAP, namely rural development support (RDP), and they are not performed for other types of support (e.g., support for the stabilisation of agricultural markets). The work procedures of the NAO require that the NAO coordinates and specifies the facts in cooperation with the audit subject (in this case, the Ministry of Agriculture and ARIB as its division). The NAO did not receive any information on monitoring during the verification of facts.

Managing authority is responsible for coordinating the implementation of CAP, as well as efficient, effective and accurate management and implementation of the Rural Development Plan.

97. The managing authority coordinates the preparation, development and evaluation of the Rural Development Plan, collects the information required for monitoring, performs the tasks related to disclosure, etc. The functions of the managing authority are performed by the Ministry of Agriculture.

Paying agency is responsible for the eligibility of expenditures.

98. The paying agency performs the functions related to the implementation of support – processes applications, makes decisions on granting support and making payments, forwards payment orders, manages information systems, collects, processes and preserves monitoring data. The functions of the monitoring authority are performed by the Agricultural Register and Information Board (hereinafter also ARIB). The authority has delegated some of its control duties (e.g., verification of compliance of the information included in the processed applications) to so-called inspection bodies: Plant Production Inspectorate, Agricultural Research Centre, Tax and Customs Board. The control functions of the paying agency are performed also by the Veterinary and Food Board and Customer Protection Board (according to their statutes).

Certifying body is responsible for the certification of the management and control systems of the paying agency, and evaluation of the annual reports of the paying agency.

99. In the period 2004-2006, the functions of the certifying body (appointed by the managing authority) have been performed by AS PricewaterhouseCoopers.

Controlling the use of support

Pursuant to Council Regulation (No 1258/1999), the Community may finance only expenditures effected by **paying agencies accredited** by the Member States.

100. The main CAP implementation control measures include accreditation, certification, monitoring, evaluation, supervision and auditing. Monitoring and evaluation are performed only for one part of CAP, namely rural development support (RDP), and not for other types of support (e.g., support for the stabilisation of agricultural markets). The management and control systems of the managing authority, paying agency and inspection bodies are audited and the applicants are inspected on site. As the majority of CAP support is allocated on the basis of compliance with specific requirements when the application is submitted, the expense receipts are not audited in the case of CAP support, unlike the support from the Structural Funds and the Cohesion Fund.

Certification audit is used to evaluate the efficiency of the internal audit system and recognition of the support-related data in the accounting records.

101. In addition to accreditation, the managing authority is also responsible for organising the certification of the paying agency by ordering annual certification audits from an independent organisation. The certifying body confirms with an annual certificate that the annual report of the ARIB presents a materially fair and accurate picture of the payments made by the paying agency. The control bodies have been also audited in the course of previous certification audits: Tax and Customs Board, Agricultural Research Centre, Veterinary and Food Board.

102. In the reviewed period, the managing authority has not ordered from the certifying body and the certifying body has not prepared an assessment on the purposeful use of the support.

103. **The NAO is of the opinion** that, in addition to certification of the annual report, it is also important to gain assurance from the independent external auditor concerning the purposeful use of the support. This is particularly important, because irregularities in the use of the support may lead to reclamations of the paid support.

104. **Recommendation of the NAO to the Minister of Agriculture:** Consider ordering from an external auditor an annual assessment on the purposeful use of support paid on the basis of the Common Agricultural Policy. This may also be carried out in the course of the annual report certification audit.

Response of the Minister of Agriculture: We would like to point out that a clear differentiation should be made between different types of support and purposefulness of the use cannot be assessed in the case of all CAP support measures. For example, the purpose of direct payments is not supporting certain future activities of the farmer (such as investment support for purchasing a tractor) but compensating the farmer for the expenses from agricultural activities in the economic unit (based on area in hectares or cattle number) in order to offset price fluctuations and increase the competitiveness of the farmer. In such case, it is possible to evaluate whether the amounts paid by the ARIB were paid according to the rules and for the intended purpose (support was paid for actual livestock and land, which has been maintained as required).

In addition, the report does not enable clear understanding of the justification behind the recommendation of the NAO. The scope of the certification audit has been established by Article 5 of the Commission Regulation No 885/2006. Pursuant to this Article, certification audit also includes compliance checks. Consequently, the scope of the certification audit includes an assessment of the regularity or purposefulness of the activities (incl. payments) of the paying agency (ARIB). The Ministry of Agriculture believes that the compliance tests performed during annual certification audits are sufficient in case of all types of support.

In the case of support where the support funds are allocated for a specific purpose, the ARIB checks prior to or after payment of the support the performance of the supported activity, i.e., the purposeful use of the support. In the case of support where preservation of certain conditions during a specific time period is required (e.g., a commitment period of five years in the case of agri-environmental support), the paying agency verifies the performance of the obligation randomly during the commitment period.

The certification audit, in turn, confirms that the control system of the ARIB complies with Community rules.

Commentary by the NAO: The NAO has described the CAP support in more detail in items 1-27 and considers it important to point out that the Special Report is a generalisation. In our recommendation, we emphasised the need to evaluate the purposeful use of the support. Naturally, the recommendation to evaluate the purposefulness of the use of support applies to the types of support where evaluation of purposefulness is possible.

The NAO does not share the opinion of the Minister of Agriculture on the scope of the certification audit. Article 5 (3) of Commission Regulation No 885/2006 states that the certification body shall draw up a certificate stating whether it has gained reasonable assurance that the accounts to be transmitted to the Commission are true, complete and accurate and that the internal control procedures have operated satisfactorily. In the resulting practice, the Commission receives an assessment on the accuracy of the annual report, including an evaluation of the part of the internal audit system that concerns the design and preparation of the report. The main objective of the respective compliance tests is to identify whether that specific part of internal audit system operates or not, i.e., to find out whether the financial information in the report is accurate (see also item 101 on the current practice).

It is good in the opinion of the NAO that the ARIB has created an internal audit environment where the purposeful use of the support is checked randomly. However, the NAO considers it important that the same would be assessed by an independent external auditor. The NAO thinks that this is particularly necessary in order to gain assurance within the country.

105. The managing authority is also responsible for collecting monitoring information and preparing monitoring reports. The managing authority prepares an annual monitoring report on the basis of the monitoring information received from the paying agency, evaluating the implementation of the Rural Development Plan, and forwards this report to the Monitoring Group for review and to the Monitoring Committee for approval. Then the monitoring report is submitted to the European Commission. Three monitoring reports have been submitted to the Commission during Estonia’s first financing period.

106. The managing authority, in cooperation with the RDP Evaluation Committee, coordinates ordering of evaluations of the Rural Development Plan from independent experts. In 2003, the managing authority ordered an ex-ante evaluation of the Rural Development Plan. There have been no interim evaluations in Estonia during the first financing period. Similarly to the Structural Funds, the managing authority in cooperation with the Commission is required to order an ex-post evaluation of the Rural Development Plan within two years after expiry of the financing period.

107. While the interim evaluations were not required in the first financing period, they are mandatory in the new period.

108. The management and control systems of the managing authority, paying agency and inspection bodies are audited by the internal auditors of the managing authority and paying agency within the limits of their competence.

109. During the preparation of the Special Report, the NAO found that the results and main findings of the conducted audits are not entered in any of the registers used for the implementation of support.

110. Recommendation of the NAO to the Minister of Agriculture: Ensure that the ARIB would use and develop databases created for getting a full overview of the implementation of support. This would enable to systematically collect information on the implementation of support, analyse it in various ways and, as a result, strengthen the management and control systems and plan auditing operations in a better and more efficient manner.

Response of the Minister of Agriculture: Pursuant to the EU CAP Implementation Act, a register of agricultural support and agricultural parcels has been created ant it is used to cross-check the support. The ARIB is currently processing 47 different support measures. Different support groups are processed in a special processing program developed specifically for the respective support group. Necessary information queries can be made at any time from the databases of the programs of different measure groups.

We agree with the opinion of the NAO that existing databases should be used and developed in order to get a full overview of the implementation of support. The databases can be developed and made more flexible as far as permitted by the available financial resources.

State supervision – inspection of conformity with the requirements provided by relevant Estonian and EU regulations on the basis of submitted documents, databases, on-site inspections, etc.

111. The main supervisory body that conducts state supervision over final recipients is the paying agency. Supervision over the paying agency is conducted by the managing authority.

112. The paying agency conducts administrative control of all submitted applications and carries out on-site inspections at 5 % of the applicants on average in each year. One of the duties of the paying agency is to conduct supervision over the performance of tasks delegated to the inspection bodies.

113. It was discovered during the preparation of the Special Report that the paying agency has not made any material inspections in the inspection bodies. According to the explanations of the ARIB, the inspection bodies have developed their internal procedure rules and guidelines for the performance of the tasks delegated to them. The said procedure rules have been submitted to the ARIB and have been reviewed and approved by it. In the opinion of the ARIB, such control procedure provides sufficient assurance that the inspection bodies have performed the tasks delegated to them and ensures supervision over the performance of these functions. The ARIB also believes that its actions comply with EU legislation, because they have been repeatedly audited in the course of certification audits and Commission audits.

114. The NAO does not share the opinion of the ARIB that the supervision is sufficient. Mere review and confirmation of the rules of procedure does not ensure the actual discharge of functions.

115. **Recommendation of the NAO to the Minister of Agriculture:** Ensure that the internal auditors of ARIB would organise random audits in the inspection bodies in order to gain assurance that the delegated control tasks have been accurately and materially performed. In the case of inspection bodies conducting the required inspections on the basis of their own statues, establish a system for issuing a confirmation on their activities to the paying agency.

Response of the Minister of Agriculture: We would like to point out that all the inspection bodies have been mentioned in the EU CAP Implementation Act. The duties of the paying agency (ARIB) and delegated duties of the inspection bodies (TCB, VFB and ARC) in the implementation of the market organisation support have been established by the Government of the Republic Regulation No 210 of 16 August 2007 on 'Specific Procedure for Cooperation between a Paying Agency and Inspection Bodies' (revoking the previous Government Regulation No 160 of 29 April 2004). The other inspection bodies perform their inspection duties on the basis of other acts.

The work of the ARIB should be based on Commission Regulation No 885/2006 that requires accreditation of both the paying agency and other agencies. Evaluation of the delegation of functions by the certifying body was based in the period 2004-2006 on the Commission's *Guideline N°9 – Delegation of tasks to other bodies or services* and *Guideline N°10 – Physical examinations*.

Pursuant to the accreditation conditions provided by the Commission Regulation 885/2006, the paying agency shall ensure that the respective body has effective systems for ensuring that it fulfils its responsibilities in a satisfactory manner.

Assurance that the procedures of the other bodies comply with the accreditation conditions is achieved primarily through coordination of the procedures with the ARIB. In addition, the ARIB supervises the work of the delegated bodies in the following manner:

- A responsible official of the ARIB reviews the checklists of inspections performed by the delegated bodies.

- The officials of the ARIB can always participate in the inspections conducted by the delegated bodies to gain assurance that the delegated bodies follow their own procedure rules.

In addition, pursuant to the Commission Regulation 885/2006, the paying agency shall review on a regular basis the functions delegated to confirm that the work performed is of satisfactory standard and that it is in compliance with Community rules.

Pursuant to the Government of the Republic Regulation No 210 of 16 August 2007, the ARIB shall by 30 November annually define and rank the risks associated with the relevant bodies in cooperation with the delegated inspection bodies. Consequently, the ARIB submits the audit topics to the inspection bodies as the basis for the preparation of the annual audit schedule. The inspection bodies submit to the ARIB their audit schedules for the year. After completion of the audit in the delegated body, the findings of the audit should be submitted to the ARIB. These procedures help to ensure supervision over the delegated bodies.

Due to the specific nature of the inspections conducted by the delegated bodies, the ARIB takes into account the findings of the internal audit of the respective delegated body and, if necessary, the internal audit department of the ARIB itself conducts audits in the delegated bodies. During the period 2004-2006, the internal audit department of the ARIB reviewed the inspection activities of the Agricultural Research Centre in the framework of the audit of the intervention purchase of grains. In the new financing period, the internal audit department of the ARIB will conduct readiness audits in all newly delegated bodies.

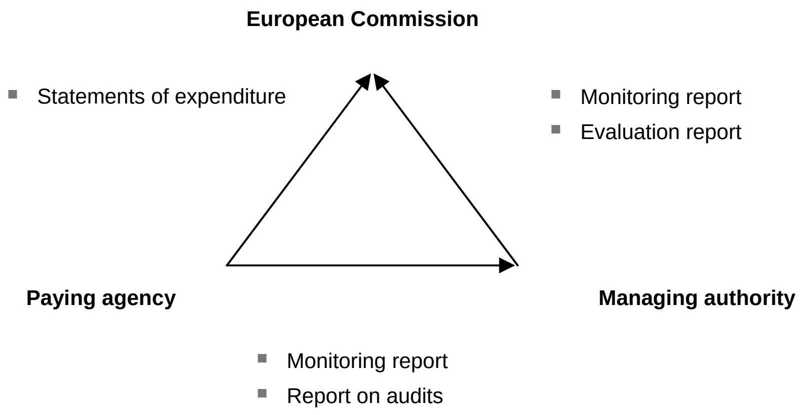
Commentary by the NAO: Despite the fact that the legislation (both EU and domestic) does not require conduct of audits in the mentioned inspection bodies, the NAO believes that the procedures described by the Minister of Agriculture are insufficient to ensure supervision over the regular and material performance of the delegated inspection functions.

The NAO maintains its position and believes that a system of issuing confirmations on their activities to the paying agency should be established in the inspection bodies that conduct the required inspections on the basis of their own statutes, and the relevant domestic legislation should be adjusted for that purpose if necessary. Currently, such system has not been created and it is not required by legislation.

Reporting to the European Commission

116. Figure 5 shows the main reports that are submitted to the Commission. As stated above, the monitoring and evaluation reports reach the Commission through the managing authority. The paying agency submits to the Commission weekly, monthly and annual expense reports. With these reports, the authority also confirms the eligibility of the expenditures.

Figure 5. Movement on main reports between the authorities



Source: National Audit Office

117. Unlike the Structural Funds and the Cohesion Fund where the functions have been divided more or less evenly, the main partner of the Commission in the implementation of CAP is the paying agency that has a full overview of the support applications and payments. It was discovered when drafting the Special Report that the Ministry of Agriculture has significantly less information on the current status than it would require in order to carry out actual management. In addition, the responsibility for the implementation of CAP has been rather vaguely defined in national legislation.

Commentary by the Minister of Agriculture: We would like to point out that CAP has been largely regulated in the European Union as a whole through regulations that are legally binding and directly applicable to the Member States. The European Union Common Agricultural Policy Implementation Act has been drafted in order to implement these regulations. This Act also provides the procedure for the implementation of the CAP support, the authorities that implement the support, as well as the bases and scope of state supervision. Within the limits of their competence the Government of the Republic or the Minister of Agriculture may enact legal instruments to implement CAP in the areas where the EU law leaves the decisions with the Member States.

Explanation of the NAO: The NAO did not understand the commentary by the Minister of Agriculture. We are of the opinion that establishing in the national legislation the requirement to submit comprehensive information to the Ministry of Agriculture is a decision that a Member State can take without any conflict with the EU legislation.

118. Recommendation of the NAO to the Minister of Agriculture: For the purpose of monitoring the activities of the ARIB, ensure the existence of sufficient information in the Ministry, requiring that copies of reports submitted by the ARIB to the European Commission should also be submitted to the Ministry for information or review, as necessary. Define the roles and responsibility of the Ministry and the ARIB in legislation.

Response of the Minister of Agriculture: Copies of the decisions of the ARIB drafted as directives are sent to the Ministry of Agriculture (incl. decisions concerning payments and reclamations of support). The reports submitted to the European Commission are drafted on the basis of these decisions. We will pay great attention to this field in our future work and we will also consider the need to receive copies of various other documents submitted by the ARIB to the Commission.

119. Pursuant to the Government of the Republic Regulation No 160 of 29.04.2004 on 'Specific Procedure for Cooperation between a Paying Agency and Inspection Bodies', the paying agency and the inspection bodies have to submit to the managing authority biannual reports on the findings of the agricultural policy support audits.

120. It was discovered during the preparation of the Special Report that the required biannual reports on the audits and implementation of the audit recommendations have not been submitted to the managing authority (except for the Tax and Customs Board that has submitted the reports according to the Ministry of Agriculture). However, the received explanations indicate that the managing authority has been kept informed of the findings of current audits. The paying agency has also prepared a summary table on audit findings and the implementation of the resulting recommendations. The NAO found during the preparation of the Special Report that this summary does not include all audits conducted in the framework of CAP.

121. Recommendation of the NAO to the Minister of Agriculture: Harmonise the content and procedure of submission of the report on completed audits to the Ministry. Impose also the obligation to collect information and submit it in its entirety to the ARIB that needs to have information on the problems found during the audits due to its functions as the paying agency.

Response of the Minister of Agriculture: The Government of the Republic Regulation No 210 of 16 August 2007 on 'Specific Procedure for Cooperation between a Paying Agency and Inspection Bodies' has harmonised the content of the report on completed audits to be submitted to the Ministry and has established a relevant format. We do not consider it necessary to change the procedure of submission.

122. Recommendation of the NAO to the Minister of Agriculture: Establish a management and control system of financial support that would allow assuring the European Commission that support paid for the implementation of the Common Agricultural Policy has been used in accordance with the rules and purposefully.

Response of the Minister of Agriculture: As of the financial year 2007, the head of the paying agency submits together with the annual report also a statement of assurance (1290/2005, Article 8 (1) (c)) confirming that (885/2006, Annex II):

- The data presented give a true, complete and accurate view of the expenditure and receipts for the financial year mentioned. All debts, advances, guarantees and stocks have been recorded in the accounts, and all receipts collected relating to the EAGF and the EAFRD have been properly credited to the appropriate funds.
- There is in place a system, which provides reasonable assurance on the legality and regularity of the underlying transactions, including that the eligibility of demands and, for rural

development, the procedure for attributing aid, are managed, controlled and documented in conformity with Community rules.

Commentary by the NAO: In the assessment of the NAO, the mentioned statement of assurance does not entail a confirmation of purposeful use of the funds. Even though the EU legislation has not imposed such obligation on the Member States, Estonia should pay more attention to this and first start to plan and then implement the activities required for the assurance.

Organisation of the protection of the EU financial interests in Estonia

Protection of the EU financial interests aims at ensuring the best possible use of the EU taxpayers' money. For that purpose, the Member States have to report any instances of fraud and other violations that harm the financial interests of the Community.

123. The European Anti-Fraud Office (OLAF) has been established at the European Commission to ensure protection of the EU financial interests. In Estonia, the functions of the cooperation partner of OLAF are performed by the Financial Control Department of the Ministry of Finance that reports any violations in the use of the Structural Funds and the Cohesion Fund, ensures exchange of information and cooperation, and increases the awareness of the authorities associated with the protection of the financial interests of the EU. In the field of Common Agricultural Policy, the Agricultural Registers and Information Board serves as the cooperation partner for OLAF.

124. The system of violation notifications operates both through prompt notifications and regular reporting: in the case of violations associated with the Structural Funds or the Cohesion Fund the intermediate body or final beneficiary, respectively, has to notify the Ministry of Finance of the violation or a suspicion of violation. In addition, the final beneficiary has to submit quarterly violation reports to the intermediate body and notify the intermediate body annually of the money subject to repayment. The intermediate body endorses these reports and forwards them to the Ministry of Finance.

125. The Financial Control Department of the Ministry of Finance has to submit quarterly notifications to OLAF concerning any irregularities with a cost exceeding 10,000 EUR (the limit was 4,000 EUR until 2006).

126. In the case of violations associated with CAP support, the paying agency itself notifies OLAF once a quarter and a copy of the respective letter is also sent to the Ministry of Finance and to the Tax and Customs board if a violation associated with export refunds was discovered. However, the paying agency is not required to report the violations to the managing authority.

127. **Recommendation of the NAO to the Minister of Agriculture:** Establish a requirement that a copy of the violation report should submitted to the managing authority as well.

Response of the Minister of Agriculture: Copies of all decisions of the ARIB drafted as directives are sent to the Ministry of Agriculture (incl. decisions concerning payments and reclamations of support). In the future, we will also demand submission of copies of the CAP violation reports to the managing authority.

128. In the case of a violation, the support is reclaimed from the final recipient by the person that made the decision to grant support: this is usually the final beneficiary in case of the Structural Funds, the intermediate body in case of the Cohesion Fund, and the paying agency in case of the CAP support.

129. In the case of reclamation of the support from the Structural Funds and CAP, the support is reclaimed from the final recipient and the paying authority or paying agency reduces the amount applied for from the European Commission by the reclaimed amount. This means that the money reclaimed from the final recipients is used for the payment of support on the basis of new applications.

130. The situation is different in the case of the Cohesion Fund, because the Member State may not use the money reclaimed from a final recipient to make other support payments. All recovered amounts should be returned to the European Commission, which for the state means essentially deprivation of the support.

Reporting to the Government of the Republic and the Parliament

Reports submitted to the Government of the Republic

131. Pursuant to the Government of the Republic Regulation No 169 of 30.04.2004 on 'Procedure for Applying for, Use, Supervision and Evaluation of Foreign Aid', the Ministry of Finance was required to submit to the Government for approval an annual **summary report on the use and efficiency of the foreign aid** in 2004 and 2005. In addition, **quarterly overviews** were submitted.

132. After legislative amendments, the Ministry of Finance submits as of 2006 only quarterly overviews of the use of foreign aid. Submission of the summary report is no longer required.

133. The summary report on 2004 provided an overview of the EU pre-structural aid and bilateral assistance programmes, including a list of the assistance and support allocated to Estonia, description of implementation and supervision, and evaluation of the efficiency of the implementation of foreign aid projects. The report did not include information on the implementation of the Structural Funds, the Cohesion Fund and CAP, because the said Regulation was not applicable to these funds.

134. The summary report on 2005 already included information on support received from the Structural Funds, the Cohesion Fund and on the basis of CAP. According to the explanations received, the 2005 report was submitted together with the quarterly report and, therefore, other topics associated with the funds were included.

Monitoring reports provide an overview of the economic situation, implementation progress, financial information, policies, financial control, etc.

135. The 2005 summary report highlighted financial information and main problems related to implementation (too low payments, etc.). However, the report did not include information on whether the established objectives (performance indicators) were achieved with the help of the support funds. In principle, the information on performance indicators is included in the monitoring reports, but no specific summary report on this aspect was submitted to the Government of the Republic. The Ministry of Finance explained this by stating that the monitoring reports are public, everyone interested can read them on the web page of the Structural Funds and, besides, they are very large documents.

136. In addition to the summary reports on foreign aid, the Ministry of Finance has after 2004, once a quarter on average and 12 times in total, submitted to the Government of the Republic current overviews of the use of foreign aid. These overviews focus primarily on the implementation of the EU support (Structural Funds, Cohesion Fund, Schengen Facility programme, except for CAP support).

137. The quarterly overviews describe the use of support through financial indicators (the status of projects, the extent of granted applications and amount of payments, etc.) and highlight current problems that need solving. The quarterly overviews do not inform the Government of the Republic of the performance of foreign aid nor the achievement of the established objectives, either.

138. With regard to the CAP support, the annexes to the quarterly foreign aid overviews only provide information on the use of the funds and discovered violations. However, there was no information on the main problems discovered in connection with the use of the support or the achievement of the established objectives (performance indicators). The Government of the Republic has not asked this information from the Ministry of Agriculture and the Ministry of Agriculture has not submitted the information to the Government of the Republic on its own initiative.

139. The cabinet meeting of the Government of the Republic on 14.10.2004 decided that, in the future, the Minister of the Interior will present to the cabinet meetings monthly overviews of the utilisation of the Schengen Facility programme funds and the Minister of Finance will present overviews of the use of foreign aid. This decision was caused by the fact that, after being informed of the problems associated with the use of the Schengen Facility funds by the Minister of Finance, the Government of the Republic concluded that full utilisation of the assigned amounts would be unlikely, considering the limited timeframe of the programme.

140. After October 2004, the Minister of the Interior has presented to the Government ten overviews of the use of the Schengen Facility funds. The Minister of the Interior informed the Government of the Republic of discovered problems and planned measures.

141. The Government of the Republic has taken note of the overviews presented by the Minister of Finance and Minister of the Interior on the implementation of foreign aid (incl. Schengen Facility) and of the opinions of other Ministers in this matter. The Government has also adopted implementing instruments that govern the use of the structural assistance. If the quarterly overviews on the use of foreign aid have highlighted problems or potential risks, the Government of the Republic has charged the Ministers with specific tasks to eliminate the highlighted shortcomings.

142. Consequently, the information available to the Government of the Republic and the measures implemented on that basis depend on the content and quality of the reports presented to it. The current practice also indicates that the scope of information presented is different in the case of different funds.

143. Pursuant to the Government of the Republic Regulation No 276 of 22.12.2006 on ‘Procedure for Monitoring and Evaluating Structural Assistance and Establishment of the Monitoring Committee’, the

Ministry of Finance, in cooperation with the intermediate bodies, shall prepare a summary report on the implementation of the national strategy by the end of 2009 and 2012. The reports should be based on the annual monitoring reports of the operational programmes and other relevant sources and the Ministry of Finance should submit them first to the Government of the Republic and then to the European Commission for endorsement. In order to endorse the said reports, the Government of the Republic needs a thorough overview on how the support has been used in Estonia.

144. **In the assessment of the NAO,** it is important that the Ministry of Finance or the steering ministries inform the Government of the Republic annually, in addition to the financial indicators and problems that need solving, also of the attainment of the objectives – the effectiveness of the use of the funds. The Ministry of Agriculture should present, in addition to financial indicators and violation reports, quarterly overviews of the problems associated with the implementation of the Rural Development Plan and annual overviews of the attainment of the established objectives.

145. **Recommendation of the NAO to the Minister of Finance:** Lay down in legislation the mandatory content of reports submitted to the Government of the Republic on the use of the EU support, and the frequency of submission of said reports.

Response of the Minister of Finance: The Ministry of Finance is of the opinion that the Government of the Republic should be kept informed of the current status of the implementation of the EU support, setbacks in the implementation, potential problems that may need responding to, and other important issues that concern the grant and use of the support. We agree with the NAO that, in the future, the overviews presented to the Government of the Republic should at least once a year, after completion of the monitoring reports, also provide a summary overview of the current status of implementation and performance in the basis of the main monitoring indicators, irrespective of the fact that annual monitoring reports are public and available to everyone. If there have been any evaluations or studies that have measured the performance during the year, an overview of the conclusions of such measurements should be presented as well.

However, we would like to point out that there were relatively large differences between the Structural Funds, the Cohesion Fund and CAP instruments in the period 2004-2006 and, therefore, it is only logical that the topics discussed under individual instruments have been somewhat variable as well.

We agree that it would be useful if the Ministry of Finance and the Ministry of Agriculture would review in the light of this report the content of the overviews presented to the Government of the Republic and would harmonise them as far as possible.

At the same time, we are of the opinion that presentation of information should be as flexible as possible, because, on the one hand, the overviews should include information that is current and important at that specific moment in time and, on the other hand, the Government of the Republic has to have the opportunity to request additional information and make running arrangements with regard to the content and scope of the information presented.

We also believe that regulation of the processes at the level of legislation of general application cannot be an aim of its own, but should be derived from objective needs, particularly when they deal with the relations between the state's own institutions and agencies, not with third-party relations.

146. **Recommendation of the NAO to the Minister of Agriculture:** Lay down in legislation the mandatory content of reports submitted to the Government of the Republic on the use of the support envisaged in the Rural Development Plan, and the frequency of submission of said reports.

Response of the Minister of Agriculture: The requirements for the annual monitoring reports and final reports have been established by Article 61 of the Commission Regulation (EC) No 817/2004. Therefore, the monitoring report shall contain overviews of any changes in the general programme conditions, the progress of the programme in relation to the established objectives, the financial performance of the programme, the implementation of the programme (incl. evaluation measures, use of technical assistance, problems encountered and distribution of information), and compatibility with other Community policies. Monitoring reports are available at the web page of the Ministry of Agriculture. In addition, periodic overviews of the implementation of the RDP are presented to the Rural Affairs Committee of the Parliament. We will consider the necessity of establishing the frequency of the presentation of said reports in a legal instrument.

Reports of the Government of the Republic to the Parliament

147. During the period 2004-2006, the Parliament has received from the Government of the Republic information on the use of the EU support mainly through the foreign aid overview, financial tables and the consolidated annual report of the state processed and forwarded by the Government. The Ministry of Agriculture has presented information on CAP support to the Rural Affairs Committee of the Parliament in response to the questions submitted by the Committee.

148. Following a request by the EU Affairs Committee, the Government of the Republic presented on 09.07.2004 an overview of the use of the EU support in the first half of 2004.

149. In its 2005 November session, the EU Affairs Committee decided that the Ministry of Finance should start submitting to the Committee monthly financial tables and quarterly overviews of the use of the support. As of November 2005, the Ministry of Finance has submitted to the EU Affairs Committee in each month all financial tables and the foreign aid overviews that have been discussed at the cabinet meetings. The EU Affairs Committee has discussed the overviews of the use of the EU support in four sessions since 2004.

150. The joint session of the EU Affairs Committee and the Foreign Affairs Committee in December 2006, discussing the new financial framework of the EU, decided that the Government of the Republic shall inform the EU Affairs Committee of the current progress of the negotiations.

151. In addition, the Parliament discusses the consolidated annual report of the state that includes a management report of the state in general and financial reports, including information recognised in accounting about the foreign aid received and granted.

152. The management report of the 2004 consolidated annual report of the state mentions that negotiations of the National Development Plan have been closed successfully and on time, and preparation for the administration of the EU support has been ensured. The report also states that the EU CAP Implementation Act has entered into force and the sessions of the Agriculture and Rural Development Council have taken place.

153. The management report of the 2005 consolidated annual report of the state mentions protection of the Estonian and EU financial interests as a strategic objective. According to the explanation, the use of the funds received from the EU in 2005 was audited to the extent of 600m EEK and 24 violations were reported to the European Commission (incl. 41.8m EEK of repayments made to the Commission) for that purpose. The report also describes that the number and structure of farmers have started to stabilise as a result of the CAP market organisation and support measures; the cooperation between farming and food sector has increased, and implementation of new technologies is increasing.

154. As stated above, the overviews of the use of the EU support do not contain all necessary information: they do not indicate whether the planned objectives were attained with structural aids and agricultural refunds or what problems have been identified in relation to the payment of agricultural refunds.

155. **Recommendation of the NAO to the Minister of Finance:** Tie management reports to strategic planning in a way that the state's management report would make clear how each ministry has used the EU support and which results have been achieved regarding strategic objectives.

Response of the Minister of Finance: An integrated renewal of the Estonian financial management system in cooperation between the ministries has been launched on the initiative of the Ministry of Finance and, in this year, it will focus on elaboration of the concept of the development or renewal of the financial management. The representatives of the NAO are also involved in this work. The main objective in renewing the financial management system is transition to a performance- and activity-based system using the accrual method, and the content and process of state reporting should be developed correspondingly. An additional objective with regard to reporting is to consolidate the entire state reporting into an integrated system similar to the already operating integrated planning, i.e., combine as far as possible the consolidated reports on the use of state budget funds with the (consolidated) reports on the use of foreign funds. This would be achieved, in particular, in the context of developing the management reports of the state – in order to obtain and transmit a better overview of the effectiveness of the use of financial resources. Therefore, we are already planning to take the steps in the direction recommended by the NAO. The specific format and content of combined reporting and the schedule of implementation will be clarified during the next stages of the process of the development of financial management.

We would also like to note, considering the assessment in clause 144, page 29, of the NAO report, that the above described integrated reporting enables both the Parliament and the Government of the Republic to get an annual comprehensive overview of the effectiveness of the use of financial resources derived from both the public revenue and foreign funds. The management report of the state will be discussed, first, by the Government of the Republic and, if approved, it will be then forwarded to the Parliament. We do not see any need for a separate additional consolidated annual report on the use of foreign funds.

Use of the European Union Financial Support in Estonia

156. The objective of this chapter is to provide an overview of the numbers and practice of the use of the EU financial support, highlighting the main problems in the processing of the support and the discovered irregularities. A brief section is devoted to the findings of the European Commission and Court of Auditors audits concerning Estonia. There are also summaries of the relevant audits of the NAO.

Use of the EU support

157. The NAO wanted to obtain an overview of the extent of the support that Estonia has received from the EU budget in the period 2004-2006.

158. According to the calculations of the European Commission[2], the support granted to Estonia was 201.8m EUR (3.2bn EEK) in 2004 and 248.7m EUR (3.9bn EEK) in 2005. According to the information of the Ministry of Finance, Estonia has received 199m EUR in 2004 and 234.7m EUR in 2005. It appears that the data of the Ministry of Finance and the Commission do not match (see Table 1). The NAO attempted to identify the causes of this difference and approached the Commission. The NAO did not receive the requested information.

159. A likely cause could be that the Ministry of Finance only has information on the support that was paid to the State Treasury and has no information on the amounts paid directly to the bank accounts of the applicants (e.g., support from the Socrates, Leonadro da Vinci and Youth programmes). Another reason of the difference could be the time delay caused by the fact that the Commission has included the amounts that were transferred to Estonia at the end of the year but were received in the subsequent year according to the Estonian accounts.

[2] "Allocation of 2005 EU expenditure by Member State", EC September 2006

Table 1. Support received by Estonia in comparison with the Commission records (million EUR)

Fund	Received by Estonia in 2004	Paid by the Commission in 2004	Difference	Received by Estonia in 2005	Paid by the Commission in 2005	Difference
Agriculture*	15,6	15,6	0,0	76,3	76,5	-0,2
Structural assistance, incl.	37,1	37,5	-0,4	67,9	72,0	-4,1
EAGGF	5,7	5,7	0,0	21,0	21,0	0,0
FIFG	1,2	1,2	0,0	2,1	2,2	-0,1
ERDF	22,6	22,6	0,0	40,2	40,2	0,0
ESF	7,6	8,0	-0,4	4,6	4,8	-0,2
CF	0,0	0,0	0,0	0,0	3,8	-3,8
Total	**52,7**	**53,1**	**-0,4**	**144,2**	**148,5**	**-4,3**
Others**	146,2	148,7	-2,5	90,5	100,2	-9,7
TOTAL	**199,0**	**201,8**	**-2,8**	**234,7**	**248,7**	**-14,0**

*EAGGF Guarantee Fund

**In Estonian records: pre-structural aid, „Transition Facility", „Equal", „Schengen Facility", compensations; in the Commission records: internal policies (incl. „Socrates", „Leonardo da Vinci", „Schengen Facility", „Transition Facility"), administrative expenses, pre-structural aid, compensations

Source: NAO on the basis of the data of the Ministry of Finance and the EC publication "Allocation of 2005 EU expenditure by Member State"

160. During the financing period 2004-2006, Estonia had the opportunity to use *ca* 20bn kroons from the EU funds, including a total of 17.5bn kroons from the Structural Funds, the Cohesion Fund, EAGGF Guarantee Fund, and the Equal and Schengen Facility programmes.

161. Estonia received in the said period 50 % of the total amount of support and payments were made in the extent of 49 % of the total amount of support. The full amount of support was received from the Schengen Facility programme and 87 % was received from the EAGGF Guidance Fund. The least percentage was received of the Cohesion Fund support – 29 % of the total amount.

162. The most payments were made from the EAGGF Guidance Fund and FIFG, with 64 % and 66 % of the amount of support, respectively, and the least payments were made from the ESF and Cohesion fund, with 29 % and 38 %, respectively. Compared with the total amount of support, 8.9bn kroons, or 51 % of the funds, remained unpaid as on 31.12.2006.

163. According to the rule of the use of foreign aid (n + 2), support may be used for up to two years after expiry of the financing period, i.e., until 2008 (except for the Cohesion Fund that may be used until 2010), and applications may be processed and funding decisions may be made for up to two years after the allocation of the respective amount. The allocation is based of the financing table for individual years, provided in the NDP, which means that funds allocated for 2004 had to be used by the end of 2006 and funds of 2005 had to be used in 2007. As on 31.12.2006, granted applications amount to 92 % of the total funds (see Table 2).

Table 2. Total amount of support and budget, receipts, grant of applications and use in 2004-2006 (million kroons)

Fund	Total amount of the fund allocated to Estonia*	Expenses planned in the Estonian state budget	Difference between the fund amount and budgeted amount	Estonian receipts from the total amount of funds, %	Granted applications of the total funds, %	Used of the total funds, %
ESF	1 084	920	-164	40	87	29
ERDF	3 643	3 201	-442	50	91	45
EAGGF Guidance Fund	889	878	-11	87	84	64
FIFG	195	195	0	66	93	66
NDP TOTAL	**5 811**	**5 193**	**-617**	**54**	**89**	**46**
Schengen	1 205	1 412	207	100	100	50
Equal	64	50	-14	45	88	40
ISPA/ CF	6 709	4 093	-2 616	29	101	38
TOTAL	**13 788**	**10 748**	**-3 040**	**46**	**96**	**42**
EAGGF Guarantee Fund (RDP)***	3 716	4 489	772	67	81	73
GRAND TOTAL	**17 504**	**15 236**	**-2 268**	**50**	**92**	**49**

*Total amount of the fund – the amount of support available to Estonia in the financial period 2004-2006
**Incl. bridge financing
***The amount of the fund includes market organisation support and direct payments; applications granted includes the Rural Development Plan for 2004–2005

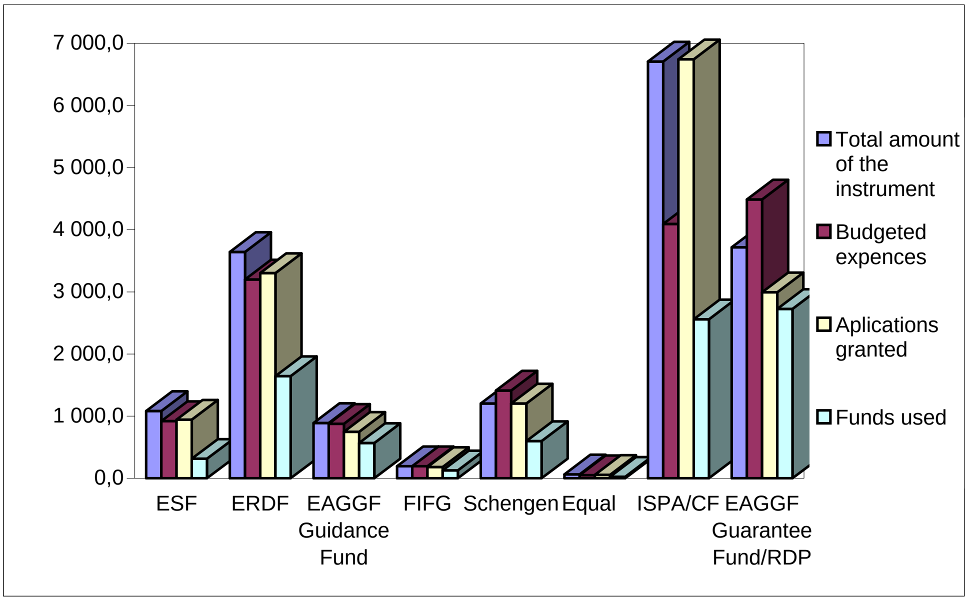
Source: National Audit Office (based in the financial tables of the Ministry of Finance as on 31.12.2004, 31.12.2005 and 31.12.2006, and ARIB information on the amount of the EAGGF Guarantee Fund and granted applications)

Bridge financing – Estonia uses its budget funds to cover the supported expenses before the respective amounts are received from the European Commission.

164. As on 31.12.2006, 1.4bn EEK, or 8 % of the total amount of support, were not covered with granted applications. This includes slightly over 600 million kroons of uncovered Structural Funds. It means that, in addition to processing the support applications of the new period, the applications for the support of the previous period need to be processed as well, which clearly increases the administrative burden.

165. Figure 6 shows the total amount of support and planning in comparison with applications granted and payments made. The planned budget amount indicated on the figure may exceed the total amount of support if the budgeted but unused funds have been carried over into the next year, e.g., Schengen Facility and Rural Development Plan support. The amount of granted applications could be higher than the budgeted amount (e.g., ESF and ERDF), because the budgeted support amounts are estimates.

Figure 6. Total amount of support, budgeted expenses, granted applications and use of the support in 2004-2006 (million kroons)



Source: National Audit Office on the basis of data from the Ministries of Finance and Agriculture

166. The following table shows the budgeting and use of the support individually by the government areas of the State Chancellery and the ministries. The highest amount of support has been budgeted in the government area of the Ministry of Agriculture, with 5.6bn EEK (i.e., 37 % of the support funds), followed by the government area of the Ministry of Economic Affairs and Communications, with 3.8bn EEK (25 %), the government area of the Ministry of the Environment, with 2.2bn EEK (15 %), and the government area of the Ministry of the Interior, with 1.9bn EEK (12 %).

Table 3. Budgeting and use of the support by the government areas in 2004-2006 (million kroons)

Division of support funds between the ministries	Planned expenses of the state budget 2004-2006	Support funds used* 2004–2006	Budget implementation %
State Chancellery (SC), incl.	**41**	**16**	**40**
ESF	37	15	40
ERDF, incl. TA	3	1	38
Equal	1	0	29
Ministry of Education and Research (MoER), incl.	**833**	**381**	**46**
ESF	460	72	16
ERDF, incl. TA	371	309	83
ISPA/CF**	1	0	0
Ministry of the Environment (MoE), incl.	**2 247**	**1 018**	**45**
ERDF, incl. TA	153	89	58
ISPA/CF	2 094	930	44

Ministry of Economic Affairs and Communications (MoEAC), incl.	**3 829**	**2 067**	**54**
ESF	56	42	75
ERDF, incl. TA	1 776	793	45
ISPA/CF	1 998	1 231	62
Ministry of Agriculture (MoA), incl.	**5 602**	**3 446**	**62**
EAGGF Guidance Section	878	568	65
FIFG	195	128	66
ERDF, incl. TA	40	25	62
EAGGF Guarantee Section, incl. RDP	4 489	2 725	63
Ministry of Finance (MoF), incl.	**46**	**32**	**70**
ERDF, incl. TA	44	25	56
CF, incl. TA***	0	7	0
Schengen	1	1	100
Ministry of the Interior (MoI), incl.	**1 887**	**953**	**51**
ERDF, incl. TA	515	370	72
Schengen	1 372	583	43
Ministry of Social Affairs (MoSA), incl.	**714**	**245**	**34**
ESF	367	186	51
ERDF, incl. TA	298	34	11
EQUAL	49	25	51
Ministry of Foreign Affairs (MoFA), incl.	**39**	**15**	**38**
Schengen	39	15	38
TOTAL	15 236	8 173	54

*Actual payments, incl. bridge financing

**The ISPA/CF support was included in the budget of the Ministry of Education and Research only in 2004, but it was not used then

***There is no data on the CF technical assistance budget of the Ministry of Finance, only the use has been registered in the amount of 6.3m EEK

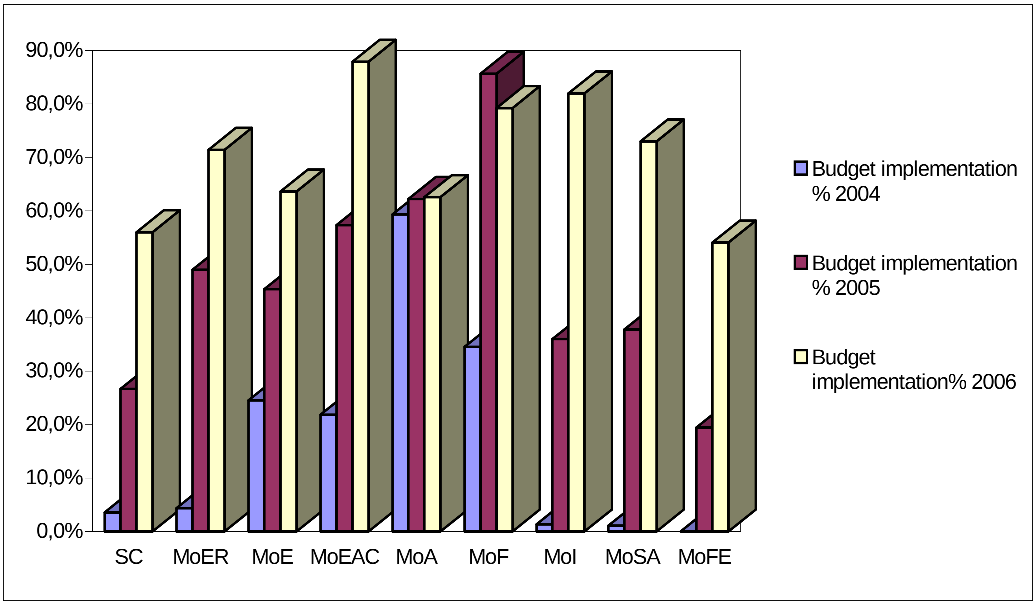
Source: National Audit Office (based in the financial tables of the Ministry of Finance as on 31.12.2004, 31.12.2005 and 31.12.2006, and ARIB information on the use of the EAGGF Guarantee Section)

167. The budgeted amount of expenses in the period 2004-2006 was 15bn EEK and 54 % of that amount was actually used (see Table 3).

168. The Ministry of Agriculture was most assiduous in implementing the planned support, managing to use on average 62 % of the support funds in the Ministry’s budget. More than 50 % of the budgeted support was used, in addition to the Ministry of Agriculture, also by the Ministry of Economic Affairs and Communications, Ministry of Finance and Ministry of the Interior.

169. The NAO analysed the planning and implementation of the budget in the three years. The results of the analysis enable to claim that budget planning has become more accurate with each year (see Figure 7). An exception to this rule is the Ministry of Agriculture that has remained at a steady level of 60 % of budget implementation in the period 2004-2006.

Figure 7. Budgeted and used support funds in the period 2004-2006 by individual government areas (%)



Source: National Audit Office (based in the financial tables of the Ministry of Finance as on 31.12.2004, 31.12.2005 and 31.12.2006, and ARIB information on the use of the EAGGF Guarantee Section)

170. While the ability to implement the budget was still relatively limited in 2004 in several government areas, the average budget implementation rose to 53 % in 2005 and to 73 % in 2006, indicating that the accuracy of budget planning has significantly improved. The reasons of under-implementation of the budget in the period 2004-2005 were the following:

- lack of previous experience (except for the Ministry of Agriculture);
- delays in the accreditation of the bodies implementing the support and the resulting delayed receipt of applications;
- the applicants were not all equally capable of preparing the applications at the required level of quality;
- insufficient distribution of information;
- problems with the organisation of public procurements, etc.

Under-utilisation of the support was partially also caused by the knowledge that the support allocated for the financial period 2004-2006 could be paid for up to two years after expiry of the period. At the same time, the level of utilisation of Estonia' own budget funds is significantly higher – 97 % on average.

171. **The NAO is of the opinion** that more attention should be paid in the future to the management of the use of support in order to maximise the utilisation and efficiency of the available financial support (see also items 193-194).

Audits on the use of structural assistance

Main results of the applied control measures

172. There have been 188 audits in total on the use of structural assistance, including 15 % (48) on the management and control system (incl. accreditation audits) and 75 % (140) on expense receipts (see Table 4). The majority of these audits have been conducted by the auditing authority and internal auditors. In addition to some accreditation audits, two audits have been ordered from external auditors and there have been two joint audits with audit companies.

Table 4. Audits on the use of the Structural Funds by priorities

Priority	Total audits conducted	Audits of the management and control system	Audits of expense receipts	Number of audit findings
1. Human resource development (1.2bn)	61	16	45	47
2. Competitiveness of enterprises (1.1bn)	50	4	46	35
3. Agriculture, fisheries and rural development (1.1bn)	43	18	25	42
4. Infrastructure and local development 2.2bn)	29	8	21	43
5. Technical assistance (0.2bn)	5	2	3	5
TOTAL	**188**	**48**	**140**	**172**

Source: NAO on the basis of data of the Ministry of Finance as on 31.12.2006

173. Financial support for the development of human resources has been the most audited area (61 audits), including 16 audits of the management and control system and 45 audits of expense receipts (see Table 4). The least audited area has been the support for technical assistance and this seems reasonable, because the amount of financial assistance in this field is the lowest compared with other priorities.

174. A total of 172 findings have been made during all the audits (see Table 4). The audit findings are relatively evenly distributed between the first four priorities. The main audit findings by priorities and findings are presented in Annex 4.

175. There were some recurrent shortcomings discovered during the audits:

- in the creation and running of the management and control systems, e.g., lack of or insufficient procedure rules and failure to comply with the rules;
- in the legal framework, e.g., regulations, measure implementation conditions and job descriptions needed improvement;

- in the decisions made, e.g., the decisions of the final beneficiaries were not sufficiently motivated when processing the projects;
- evaluation of the content of the projects, e.g., suspicions regarding the objectivity of the consultants used for evaluating the applications;
- in the organisation of accounting, e.g., the accounting records of the final recipient did not comply with applicable legislation and the movement of money from the Structural Funds was not clearly traceable in the accounting records;
- in the organisation and documentation of public procurements, e.g., in some cases, less than three comparable price offers were obtained;
- in the execution of documents (incomplete applications, reports, etc.), e.g., the applicants had submitted and the final beneficiaries had granted applications that included significant deficiencies;
- in electronic information systems (incl. the register of structural assistance), e.g., incomplete data on the projects in the register of structural assistance;
- in the compliance with the publicity requirements, e.g., the objects did not have the required stickers;
- in the compliance with expenditure eligibility requirements, e.g., project included provision of training, which could not be financed from the measure.

176. Many deficiencies in the management and control systems discovered during the audits have been and may become decisive in the reclamation of funds by the European Commission.

On-site inspections on the use of the Structural Funds

On-site inspection or on-the-spot check is conducted in order to make sure that the project actually exists and that it is implemented in accordance with the provisions of the decision to grant support. It also includes verification that the declared expenditures have been actually made, the expenditures are eligible, comply with legislation and have documentary evidence.

177. A total of 4308 on-site inspections were conduced by the final beneficiaries during Estonia's first financing period as on 31.12.2006. Table 5 presents a summary of the on-site inspections conducted by final beneficiaries in each of the priority areas of the NDP.

Table 5. On-site inspections conducted by the final beneficiaries as on 31.12.2006

Name of the priority	Number of on-site inspections
1. Human resource development (1.2bn)	215
2. Competitiveness of enterprises (1.1bn)	246
3. Agriculture, fisheries and rural development (1.1bn)	3651
4. Infrastructure and local development 2.2bn)	182
5. Technical assistance (0.2bn)	14
TOTAL	**4308**

Source: Agricultural Registers and Information Board, Enterprise Estonia and the Ministry of Finance

178. The table indicates that *ca* 200 on-site inspections have been conducted for the second and fourth priority and 14 on-site inspections for the fifth priority. The on-site inspections conducted for the third priority, the use of the support for agriculture, fisheries and rural development, amount to 85 % (3651) of all on-site inspections conducted. The final beneficiary of the priority – the Agricultural Registers and Information Board – has conducted such high number of on-site inspections, because the rules require inspection of the use of the support on the basis of payment applications, and additional ex-ante checks are conducted before granting the applications and ex-post checks are conducted after the end of the project, plus additional checks are organised as required. The NAO believes that the number of on-site inspections is clearly too high considering the financial scope of the priority. The evaluator in its evaluation report has also mentioned the excessively high number of the on-site inspections of ARIB.

ASi Pricewaterhousecoopers evaluation report "Evaluation of the system of implementation of the National Development Plan and its efficiency", 7 July 2006

179. According to the explanations of the Ministry of Finance, ARIB has changed its system of on-site inspections as of the second quarter of 2006 so that it is no longer based on payment applications but on applicants, which should reduce the number of on-site inspections without interfering with the purpose of supervision. On-site inspection of the implementation of the investment of each project is carried out only once. ARIB does not want to abandon the ex-post checks, because this is in their assessment the best method to verify the purposeful use of the support during the five years. **The NAO is of the opinion** that the purpose, content and extent of the ex-post checks coincide with the audit of expense receipts.

Pursuant to Article 30 (4) of the Council Regulation 1260/1999, the Member States may grant support only if the purposeful use of the support is ensured **during five years.**

180. **Recommendation of the NAO to the Minister of Agriculture:** Consider combining the ex-post checks with the audit of expense receipts in order to use the resources efficiently and reduce interference with the activities of the final recipients.

Response of the Minister of Agriculture: We would like to point out that, in the case of investment support, the support is paid to the beneficiary after submission of expense receipts. As a rule, a project should be implemented within two years, which means that the expense receipts are also submitted during this period. Pursuant to Council Regulation (EC) 1260/1999, a Member State shall secure the contribution of the EU Structural Funds for five years of the date of the decision on the support, which means that the object has to be used for the intended purpose for five years. Considering the fact that payments are generally made significantly earlier than the five-year period, the ex-post checks and audit of expense receipts cannot be combined.

The number of inspections conducted by ARIB is in conformity with the Commission Regulation No 1975/2006 that specifies the minimum control rates for the current programming period. Pursuant to this Regulation, at least one on-site inspection is required for each project of the investment instruments in order to verify actual realisation of the investment, ex-post checks are required after payment of support to cover at least 1 % of eligible expenditure, and, additionally, on-site inspection of the expense receipts is required to cover 5 % of eligible expenditures paid.

181. According to its own information as on 31.12.2006, the paying authority had conducted 21 on-site inspections in the final beneficiaries in Estonia's first financing period. The on-site inspections of expense receipts indicated that the main area of deficiency was compliance with rules of the management and control system.

182. The NAO was unable to consolidate and analyse all deficiencies discovered during the on-site inspections due to the following reasons:

- The register of structural assistance does not contain information on the on-site inspections conducted by the paying authority, intermediate bodies and some of the final beneficiaries (there are no data on the Enterprise Estonia and ARIB).
- The final beneficiaries have not entered the discovered deficiencies in the case of some on-site inspections entered in the register.
- The register does not permit the type of query that would enable consolidating and analysing all the on-site inspections at once.
- The register does not have the functionality for the paying authority to enter the data on its own on-site inspections.

183. **The NAO believes** that the register of structural assistance that is used to keep records on the grant and use of the support and to monitor the implementation of the support should include information on all supervisory activities (incl. on-site inspections). Records on the elimination of deficiencies discovered during supervision should be kept in the register in a similar manner as the records on audit findings.

184. **Recommendation of the NAO to the Minister of Finance:** Ensure that the register of structural assistance would include records on the elimination of the deficiencies discovered during supervision (incl. on-site inspections) and develop the database accordingly if necessary.

Response of the Minister of Finance: The Ministry of Finance shares the opinion of the NAO that the functionalities provided by the register of structural should be used to their full potential. We would like to point out that the register is being continuously developed as a result of the need to improve the efficiency of data transmission, processing and analysis. Therefore, the number of usage features of the register of structural assistance has increased considerably over time. An important factor considered in the development is increasing the user-friendliness of the register so that the operations in the register would be as simple and timesaving as possible.

The register of structural assistance is a project management system and, therefore, all data in the register have been recorded by individual projects. The data entered for individual projects can be consolidated and expressed in the form of statistical reports. Information on the supervision operations and deficiencies discovered have been entered in the register since the first stages of implementation and, therefore, the basic information on the on-site inspections of individual projects is already available. However, register upgrades are being currently developed (August 2007) in order to enable classification of discovered deficiencies (and using this information for the purposes of analysis and risk assessment) and registration of the compliance with issued precepts. The development also concerns several reports associated with on-site inspections, which, among other things, will enable the user easy access to consolidated information on the number of on-site inspections, the amount of funds covered with on-site inspections, etc.

Consequently, the Ministry of Finance agrees with the recommendation of the NAO and has taken account of it.

Results of monitoring the use of the Structural Funds

Monitoring reports: No RAK2004–2006/2004/ No 01, 2 December 2004;
No RAK2004–2006/2004/A/02, 30 May 2005;
No RAK2004–2006/2005/P/03, 8 December 2005;
No RAK2004–2006/2005/A/04, 8 June 2006;
No RAK2004–2006/2006/A/05, 7 June 2007

185. Five NDP monitoring reports and one monitoring summary had been prepared as on 31.12.2006.

186. In the monitoring reports, the managing authority has provided a good assessment of the implementation of the NDP so far: the managing authority believes that, despite the delays in the receipt of some support applications and problems discovered in the implementation, they have not endangered the achievement of the objectives of the measure and priorities.

187. In summary, the monitoring reports mention the following as the main problems:

Monitoring summary provides a brief overview of the main developments and problems in the implementation of the EU Structural Funds in the period from 1.01.2004 to 20.09. 2006.

- uneven level of capacity of the applicants and limited knowledge on the requirements for the preparation of application and reporting (submission of incomplete documentation);
- deficiencies associated with public procurements (e.g., failure to use simplified procedures, unsuccessful public procurements);
- breach of publicity requirements;
- need to specify the requirements, which implies amendment of legislation (e.g., specification of the regulations of a measure);
- incorrect implementation of the register of structural assistance (incl. incompatibility of the electronic systems of some final beneficiaries with the register of structural assistance);
- different interpretations of the evaluation criteria of the applications by the experts and evaluators;
- high personnel turnover and difficulties finding new employees, etc.

188. According to the monitoring reports, the following were the main problems of the priority "Human resource development": low level of payments (as on 31.12.2006, the payments of the measure 1.1 amounted to only 14 % of the budget); complicated and time consuming processing of payments; inaccurate budget planning resulting in redirection of funds into another measure due to low level of payments (107m kroons of the budget of the measure 1.1 has been redirected into measure 4.3).

189. The main problems stated in connection with the priority "Competitiveness of enterprises" included incomprehensibility of the principles of verification of eligibility and recording of expenses for the applicants and incompatibility of the information systems.

190. The main problems mentioned in connection with the priority "Agriculture, fisheries and rural development" included long duration of the calls for proposals and processing procedures; large number of applications and the resulting lack of time for the processing of applications; shortage of allocated funds because the applications submitted significantly exceeded the budgeted amount, which created a need for additional financing; incompatibility of information systems.

Commentary by the Minister of Agriculture: Please specify the rationale behind this statement. The report reprimands the Ministry of Agriculture for the limited distribution of information and the low level of knowledge of the criteria of the measure among the applicants. However, long periods of the calls for proposals should give the applicants enough time to familiarise themselves with the criteria of the measure and prepare their applications in a more thorough manner.

Explanation of the NAO: The NAO apologises for the factual error that has remained in the report. Actually, the main problems of the priority included short (not long) duration of the calls for proposals and long duration of processing procedures.

191. The main problems of the priority "Infrastructure and local development" included the rise in the prices of construction procurements that hindered the implementation of projects (measure 4.4); modest number of applications, poor quality of the projects, failure to comply with schedules (measure 4.2); number of disputes associated with public procurements (measure 4.5); limited number of submitted applications (measure 4.6).

192. The main problems in the case of the technical assistance priority were related to the eligibility of expenditures.

193. **The NAO is of the opinion** that the findings of the monitoring are an indication of problems with administrative capacity: poor planning of the budget, complicated rules of procedure, poor preparation of projects, insufficient consultation of applicants, and high staff turnover.

194. **Recommendation of the NAO to the Minister of Finance:** Pay more attention to increasing the administrative capacity, using the experiences gained in the first financing period and preventing the recurrence of the same problems in the new period.

Response of the Minister of Finance: Undoubtedly, the administrative capacity required for the grant and use of the EU support must be ensured. Many problems mentioned in the Special Report have been discovered in the course of monitoring, which means that both the Ministry of Finance and the Monitoring Committee have been aware of these problems and have responded to them.

Among other activities, the Ministry of Finance, intermediate bodies and final beneficiaries have paid constant attention to communication, disclosure, publicity and information in order to improve the knowledge of the public, applicants and final recipients of the structural instruments and the rules related to the use of these instruments. Regular training courses are organised in the field of public procurements and the managing authority prepares guidance materials – the same is done in several other areas as well.

Most of the bottlenecks associated with the compatibility of the register of structural assistance with the information systems of the Enterprise Estonia and ARIB have been eliminated and the register of structural assistance now includes the data on the projects of all final beneficiaries.

In a situation where the grant and use of the support is essentially based on projects, the changes in conditions in the case of some projects always lead to delays and implementation problems. What is important is that there is an administrative structure able to discover to these problems (monitoring, audit, evaluation, etc., in the course of the process) and respond in an appropriate manner to solve them.

The Ministry of Finance monitors the implementation on a daily basis and strives towards a situation where the problems could be discovered and eliminated as efficiently as possible. We certainly agree that the experiences gained during the period 2004-2006 must be taken into account when preparing for the period 2007-2013 and this has been already done in a number of issues.

Results of evaluating the use of the Structural Funds

195. In addition to the macro-economical analysis of the NDP[3] and the assessment of the impact of investment on the fisheries sector (AS Helmes/OÜ HansaUuringud, September 2006), the following evaluations by foreign experts had been completed by 31.12.2006:

- Evaluation of implementation of the NDP (PricewaterhouseCoopers AS, 12.12.2005);
- Evaluation of NDP priority 1 (Ernst&Young Baltis AS, 30.06.2006);
- Evaluation of the system of implementation of the NDP and its efficiency (PricewaterhouseCoopers AS, 7.07.2006);
- Evaluation of the structure, implementation and project selection criteria of the NDP (CyclePlan OÜ, 31.07.2006).

Achievement of the objectives of the NDP is evaluated on the basis of indicators (both quantitative and qualitative data) collected in the course of monitoring.

196. The objective of **evaluation of implementation of the NDP** was to evaluate the system of monitoring. The results of the evaluation indicated that the monitoring system of the NDP operates satisfactorily, despite the deficiencies discovered. The evaluators found that

Indicators – figures established to measure the achievement of objectives by comparing them in the course of monitoring with the actual figures achieved.

- it is impractical to compile monitoring reports biannually, because the preparation of reports takes too much time;
- different parties may have different interpretations of the indicators, because the NDP does not specify that exactly is meant by indicators and where the necessary information should be collected;

[3] „The Macro Impacts of SPD 2004–2006 on the Estonian Economy" (The Economic and Social Research Institute, 23 February 2006)

- the monitoring reports do not provide sufficient input for future management decisions, because they do not include an assessment of the performance of unfinished projects;
- the register of structural assistance does not work properly and is not sufficiently user-friendly.

197. The evaluator made recommendations for solving the bottlenecks identified in the monitoring system and most of these recommendations have been taken into account in the planning for the new financing period.

198. The objective of **evaluation of the NDP priority 1** was to evaluate the compliance of the priority with the "Estonian Action Plan for Growth and Jobs 2005-2007" (hereinafter the 'Action Plan'). The results of the evaluation indicated that the NDP priority 1 is materially in compliance with the objectives of the Action Plan. The evaluator also identified some deficiencies and stated that

- the objectives have not been concretely defined and, as a consequence, the scope of the areas of activity is too large;
- the initiative of the state in starting the projects and directing the financing policy has been insufficient and, as a result, systematic development of all major fields is not ensured;
- information is not collected and the projects are not analysed in view of their compliance with strategic plans and policies;
- the indicators do not enable sufficiently adequate assessment of the efficiency of the use of the support.

199. The evaluator made several recommendations for better coordination between the Action Plan and the use of the Structural Funds and significant portion of the recommendations has been taken into account. According to the Ministry of Social Affairs, the wording of the planned actions will remain fairly general in the new financing period as well, because long-term (2007-2013) forecasts of certain changes in the labour market cannot be very accurate.

200. The objective of the **evaluation of the system of implementation of the NDP** was to evaluate the existing system of implementation. The evaluator concluded that the system of implementation of the NDP operates satisfactorily, despite the deficiencies discovered. In the future, more attention should be paid to the efficiency of the system of implementation and to focusing on the more complicated areas of the internal control system (e.g., supervision of state aid).

201. In the course of the evaluation, the evaluator made the following observations:

- The highest number of deficiencies was discovered in the case of the projects of the Labour Market board, which is caused by the overlapping of two functions (both the final beneficiary and the intermediate body).

- The legal framework of the NDP is not sufficiently flexible, because amendment of the implementing regulations of a measure takes three times longer than necessary (3-6 six months instead of 1-1.5 months).

- Estonia lacks a central database of low priority support and state aid, which causes the risk that some applicants may have received state aid exceeding the permitted limit.

- The majority of the intermediate bodies do not perform any controls when they confirm the purposeful use of the support (‘Notification of compliance of the activity’) and, consequently, the managing authority has no actual assurance that the intermediate bodies exercise supervision over the final beneficiary.

- Processing of payment applications takes too much time (40-50 days on average).

- Audits of expense receipts have been fragmented between different authorities and their number is relatively small, which is why all internal auditors of the intermediate bodies and final beneficiaries do not have sufficient workload.

- ARIB conducts too many on-site inspections, whereas ex-post check overlaps to a large extent with the purpose and scope of the audit of expense receipts.

- Only the Enterprise Estonia involves county development centres, even though their original purpose was to support the implementation of the entire NDP at the regional level.

- The authorities have different understandings of irregularities. For example, the ARIB and Enterprise Estonia tend to support a more rigid interpretation of irregularities than some other final beneficiaries.

202. The evaluator made several recommendations for better coordination of the system of implementation and significant portion of the recommendations has been taken into account.

203. The objective of the **evaluation of the structure, implementation and project selection criteria of the NDP** was to assess the objectives, structure of measures, selection criteria and system of the NDP. The conclusion of the evaluation was that the NDP has been initiated satisfactorily – the implementing systems are in function and the level of payments is good compared to other Member States. However, the evaluator found that the NDP lacked a clear focus, which reduced the clarity and implementation capacity of the programme. According to the evaluator, the main task in making the implementation system of the Structural Funds more successful is not inventing new solutions but rather improving the existing structure.

204. The evaluator highlighted the following main deficiencies:

- The objectives established in the NDP are not sufficiently realistic; the existing indicators cannot adequately reflect the level of performance; implementation of some measures (e.g., 1.1, 2.3 and 4.4) has been less successful due to demanding payment procedures.
- Using the EU financial support became a goal in its own during Estonia's first financing period. The measures of the NDP attempt to achieve several objectives at once, because preference was given to combining the existing programmes in one programming document – the NDP.
- The selection criteria do not enable to choose the projects that would contribute most to the achievement of the objectives of the NDP.
- The systems used for selecting the evaluators are not transparent and the decisions not to grant support are not sufficiently motivated.

205. The evaluator made recommendations on the structure, implementation and project selection criteria of the NDP, which, according to the Ministry of Finance, have been taken into account when preparing the operational programmes and accreditation criteria for the new financing period.

Results of the check of the use of the Cohesion Fund

206. A total of 41 audits were conducted during Estonia's first financing period. 55 major observations were made in the course of these audits, including 40 % in the environmental and 60 % in the transport sector (see Table 6). The managing authority has ordered no audits from external auditors.

Table 6. Cohesion Fund audits

Sectors of the Cohesion Fund	Number of audits	Number of observations made during the audits
Environment	24	23
Transport	17	32
Total	**41**	**55**

Source: National Audit Office (based on the data of the Ministry of Finance as on 31.12.2006)

207. The audits have revealed deficiencies similar to those in the Structural Funds with regard to the creation of and compliance with the management and control systems, eligibility of expenditures, organisation of auditing, publicity, organisation and documentation of public procurements. Several of the discovered irregularities have been decisive in and may be so in the future reclamations of the funds by the European Commission (see items 244-249). The main audit findings by the sectors and observations are provided in Annex 5.

208. According to its own information as on 31.12.2006, the paying authority had conducted 25 on-site inspections in the final beneficiaries. Most problems discovered by the paying authority during the on-site checks of the expense receipts concerned the eligibility of expenditures.

209. More than 150 monitoring reports on projects and 5 monitoring reports on the implementation of the Cohesion Fund had been prepared by 31.12.2006.

210. According to the managing authority, the administrative capacity of the intermediate bodies and final beneficiaries and the preparation of the final recipients for the implementation of projects have improved continuously.

211. According to the monitoring reports on the support from the Cohesion Fund, the main problems include poor planning of payments (the actual level of payments has been significantly lower than the planned amounts); incorrect compliance with the prepayment conditions (incl. contracts not concluded in time), disputes resulting from public procurements, uneven quality of the on-site inspections; falling behind the established schedule (due to delays in the tenders and contract conclusion, additional unexpected works, remaking of poor-quality work, poor organisation of work, delays in the submission of documents, etc.), rise in the cost of projects; high number, excessive level of detail and immeasurability of the project indicators.

212. Another problem mentioned in the monitoring report is the need to reconsider funding decisions in the case of several projects as a result of falling behind the schedule, the need to obtain more specific indicators and also constant increase in the price of the projects. It is important to consider in this respect that a funding decision can be changed only once (except for the decisions from ISPA).

213. Efforts to solve many of the said problems have already begun and some problems have been solved or are being currently solved.

Results of the check of the use of the support paid on the basis of the Common Agricultural Policy

214. Audits have been organised in the period 2004-2006 by the internal audit units of the Ministry of Agriculture, ARIB, Tax and Customs Board and the Veterinary and Food Board, as well as external auditors. The main areas of audits have been the existence of the procedure rules for the processing of support in the Ministry, ARIB and auditing authorities, compliance of the rules with the EU and Estonian legislation, and adherence to the rules in the processing of support.

Annual report certification audit

215. In the course of the certification audit (for the purposes of evaluating the annual report to be submitted to the Commission), the external auditor has reached the conclusion that the annual reports present a materially fair and accurate picture of the payments made by the ARIB. However, several deficiencies were mentioned:

- in the rules of procedure;
- in the work of the internal audit (e.g., the Agricultural Research Centre did not have a strategic plan for internal audit,

modification of the internal audit schedule had not been recorded in the ARIB);

- in the IT systems (e.g., vacant security manager position in the ARIB, lack of unified principles when entering the names of the applicants in the registers);
- in the control activities (e.g., there was no control of the access to the server room);
- in the cooperation between units (e.g., even though three units were responsible for the supervision of security, the function of supervising several security-related procedures was not formally covered in the ARIB).

216. During the 2005 and 2006 audits, the external auditor checked also the implementation of the recommendations from the last year and it appeared that the majority of the recommendations had been implemented. The recommendations that had not been taken into account included the assessment of the organisation level risks in the Agricultural Research Centre; establishment of a disciplinary procedure for instances of the breach of rules and concealment of evidence; introduction of division of work in all areas for the supervision of security.

217. The following main problems were mentioned in connection with the processing of support:

- information (general requirements for application) does not reach the applicant;
- the register of fields included data on agricultural parcels, submitted in the course of declaration of the applicants and land users, which were in part or entirely unsuitable for agricultural activities;
- labour shortage.

Audits of management and control systems and on-site inspections

218. 28 audits of management and control systems were conducted in the period 2004–2006, incl. accreditation and certification audits. A total of 781 observations were made during the audits and the main observations are presented in Table 7. All types of support paid under CAP had been audited. The highest number of audits concerned the support paid for the implementation of market organisation measures and the number of observations was also highest in this field, followed by the support for the implementation of the Rural Development Plan.

Table 7. Audits conducted in the framework of CAP implementation in 2004-2006, main observations and on-site inspections

	Audits of management and control systems	Audit observations	On-site inspections
Support for Rural Development Plan	9	20	6 849
Other support in the framework of CAP**	19	73	8 180
Other general observations***	10	42	–
TOTAL	**38**	**135**	**15 029**

*The number of audits that focussed on the respective type of support (some audits dealt with several support measures).
**Support granted on the basis of the CAP Implementation Act (e.g., market organisation support, direct payments).
***General observations made in the course of the audits on the implementation of support in general.

Source: National Audit Office (based on the data of the Ministry of Agriculture, ARIB, VFB and TCB)

219. When auditing the use of the support paid under CAP, several observations were made regarding the insufficient or lacking description of procedures or non-compliance of the descriptions with the EU or Estonian legislation (e.g., the procedures did nod indicate deadlines for the submission of applications, there were no specific details on the division of tasks, responsibility had not been defined). Other observations concerned the following:

- insufficiency or inaccuracy of documentation (e.g., deficiencies were found in the documentation of the reports on irregularities and non-compliances);
- insufficiency or lack of IT systems;
- insufficiency of the compliance checks (e.g., the results of the dairy cow check were not certified, the paying agency had not conducted joint inspections with the auditing authorities);
- processing of applications on errors, conduct of verifications or accounting (e.g., several licenses with different numbers were issued on the basis of once license applications, the reference quantity for direct sales was increased on the basis of an application for delivery reference quantity, the principle of parity of revenue and expenditures was not observed when making entries in the audit records);
- separation of functions (e.g., the Rural Development Department of the Ministry of Agriculture had to prepare an application for technical assistance and submit the application to itself; with regard to technical assistance, the ARIB served simultaneously as the applicant and the paying agency).

Commentary by the Ministry of Agriculture: We would like to point out that, when processing the CAP 2004-2006 technical assistance applications, the eligibility of the activities of other authorities is evaluated by a specialist of the Rural Development Department while the eligibility of the applications of the Ministry of Agriculture (prepared by the Rural Development Department) is evaluated by a specialist of the

Financial Department. Consequently, the separation of functions has been ensured in the preparation of applications for technical assistance.

In its Report, the NAO has drawn parallels between the implementing scheme of CAP and the implementing scheme of the Structural Funds (see also the response to item 96 of the Report). We would like to point out that in the case of the Structural Funds for example, the different departments of the Ministry of Finance perform the functions of the managing authority, paying authority, auditing authority and intermediate body.

We would also like to point out a discrepancy in the opinions of the NAO, in that the item 180 of the Report recommends combining the ex-post checks with the audit of expense receipts, which in essence would mean abandoning any verification of the purposeful use of the support.

Explanation of the NAO: In the Special Report, the NAO summarises the most frequent and important problems discovered in the past audits. The audits have been conducted by the internal auditors. This particular finding comes from the Ministry of Agriculture audit No. 2005-002 "Implementation of the technical assistance measure granted in the framework of the Estonian Rural Development Plan 2004-2006 in the Ministry of Agriculture and the paying agency". The NAO presumes that the results and findings of the audits have been discussed with both the Ministry of Agriculture and the ARIB and, therefore, any possible factual errors have been corrected and the explanations and commentaries have been taken into account where possible. The same applies to the audits of the Structural Funds and their results.

Abandoning ex-post checks does not mean abandoning the verification of purposefulness, because the audit of expense receipts also involves evaluation of the purposeful use of the support.

220. In conclusion, it could be stated that, similarly with the audits on the use of the Structural Funds and the Cohesion Fund, the audits on the implementation of CAP have focused only on evaluating the management and control systems or checking the expense receipts, but not on assessing the effectiveness of the use of support.

221. **Recommendation of the NAO to the Minister of Agriculture:** Organize the assessment of the cost-effectiveness of the use of support of Rural Development Plan as well as an assessment of the attainment of objectives.

Response of the Minister of Agriculture: We would like to point out that evaluation of the objectives of CAP could take place only on the background of the objectives arising from Article 33 of the EC Treaty (see also the response to item 5).

The general procedures for monitoring and evaluation in the case of rural development support under CAP have been provided in Chapter V of Title III of the Council Regulation (EC) No 1257/1999 and Title IV of the Council Regulation (EC) No 1260/1999. Continuous evaluation of the environmental support in the case of the RDP 2004-2006 is performed by the Agricultural Research Centre. In addition, an ex-post evaluation should be conducted after the end of the programme, starting in the second half of 2007. Normal interim evaluation of the programme was omitted due to the short duration of the programme.

Commentary by the NAO: With its recommendation, the NAO would like to point out that the minimum requirements established by the EU legislation may not be sufficient for receiving operative information within the country on the effectiveness and purposefulness of the use of the support. The NAO is of the opinion that it is possible and legally correct to evaluate the effectiveness and purposefulness of the use of support, irrespective of whether this has been provisioned in the EU legislation. Naturally, this should be done in compliance with the established requirements and without failing to perform the obligation of ex-post evaluation.

222. During the period 2004–2005, the ARIB, Tax and Customs Board, Veterinary and Food Board and the Agricultural Research Centre organised more than 15 000 on-site inspections (see Table 7). The applicants for the school milk support were the most heavily controlled group in connection with the support for the stabilisation of agricultural markets. The highest number of inspections was conducted in connection with the Rural Development Plan support (in particular, less-favoured area supplements and support for environmental production) and direct payments (single area payment and complement to direct payment for crop cultivation). The least inspected areas included renewal of forest culture, building and maintenance of stone fences, and trade support.

Monitoring reports

223. Monitoring reports for Estonian rural development plan for the years 2004, 2005 and 2006 have been drawn up for Estonia's first financing period 2004–2006. According to the monitoring report, the measures of the rural development plan are in compliance with the EU policy. Additionally, in both reports, the Ministry of the Agriculture has conveyed an assessment that the programme has been implemented without major impediments.

224. The main problems listed in the 2004 monitoring report include submission of applications after the deadline set for it and the applicants' ignorance of the requirements for receiving support. Many errors were identified in filling in the applications and due to mistakes the number of inspections increased later on, which in turn resulted in a need for more people who would be involved in the implementation and administration of measures and counselling. In 2004, *ca* 230 challenges/petitions for a review of application were submitted. Primarily, the challenges concerned sanctions arising from incompliance with the requirements set for the reception of support. From the viewpoint of the budget, there were problems with the number of applications submitted for agri-environment support being far larger than estimated. The 2004 budget was exceeded by a total of 141 %.

225. In 2005, the number of applicants who were late in submitting their applications had decreased by half. Compared to 2004, the number of submitted challenges had also decreased approximately by half. Primarily, the challenges concerned sanctions arising from incompliance with the requirements set for the reception of support. With all supports there were problems with the difference in surfaces identified during on-the-spot inspection and those presented on the application for support. With support for less-favoured areas there were many problems with the continuation and transfer of obligations. It can be concluded from the above that the applicants' level of awareness has increased in comparison with the year 2005, but they were still not always familiar with the requirements set for the reception of support.

226. Compared to 2005, the number of applicants who were late in submitting their applications had increased in 2006 – the number of late applicants amounted to 3 % of all applicants in 2006. The number of submitted challenges increased significantly in 2006. A total of 504 challenges were submitted for reviews of applications. Like in the previous years, there were problems with the difference in surfaces identified during on-the-spot inspection and those presented on the application for support. Also, many challenges were submitted where the applicants had failed to note, either due to ignorance or carelessness, whether they are applying for support for organic production or environment-friendly production. Like in the previous years, there were problems with the continuation and transfer of obligations.

227. According to the management authority, the RDP has been implemented successfully in the third year of implementation. According to the management authority, the applicants' activity refers to a great need for support as well as to the applicants' increased awareness of support measures.

228. **According to the NAO**, the large number of errors identified n the course of processing the applications refers to the applicants' lack of information or knowledge, which is why the requirements have been misinterpreted and which can be due to ARIB's poor notifying activities.

229. **The NAO's recommendation to the Minister of Agriculture:** Find out why so many errors are made in the use of supports and take measures for reducing the number of said errors.

Reply of the Minister of Agriculture: An information booklet "Assistance for Applicant" is drawn up for each support, whose purpose is to help the applicant in preparing the application for the support. In addition to this, the Ministry of Agriculture and ARIB organise information days both for agricultural advisers and applicants for support prior to the application round of each measure. Arising from this, the Ministry of Agriculture is of the opinion that notification of applicants is thorough and diverse possibilities have been created for dissemination of information.

For the better notification of applicants, the Ministry of Agriculture and ARIB have launched a cooperation project for the development of counselling and notification activities.

The compiler of the report fails to pay attention to Table 12 and item 250, pursuant to which approximately half of the infringements occurring in the use of supports in the EU as a whole have been identified mainly in the course of EAGGF funds, which can be explained by the specifics of the agricultural sector and agricultural refunds, where there are a large number of applicants. The number of types of supports paid from EAGGF is also very large, ranging from direct aids to investment aids. For example, there are approximately 19,000 applicants for single area aid in Estonia.

Comment of the NAO: The NAO is pleased that the Minister of Agriculture has understood the relevance of the emerged problem, has analysed the causes for this situation and has started to take measures.

Performed assessments

230. External independent assessors have assessed the rural development plan 2004–2006 once – ex-ante assessment of the rural development plan was carried out by AS Maves in 25.4.–22.9.2003. In the course of said assessment, they assessed the compliance of the planned strategy with the situation and objectives and checked organization of implementation and its compliance with the CAP. Simultaneously with ex-ante assessment, assessment of strategic impact of the rural development plan was also carried out. No further assessments of the rural development plan and its measures have been performed.

231. Most of the recommendations made in the course of ex-ante assessment were taken into account in drawing up the rural development plan.

232. **According to the NAO**, the scarcity of assessments also refers to the need to organise or buy in audits to assess the cost-effectiveness of the use of support (See also item 221).

Main findings on Estonia of European Commission audits

233. In Estonia, the European Commission has carried out audits in the implementation of Structural Funds, Cohesion Fund and common agricultural policy (See Table 8).

Table 8. European Commission audits in Estonia in 2004–2006

Fund	Audit/mission	Duration
ESF	Report of the ESF's verification visit – management and control systems audit OP 2003EE161DO001 and CIP 2004EE050PC001	October 2005
ESF	System audit of ESF operation, No 2003EE161DO001	December 2006 *(unfinished)*
ERDF	Inspection of performance of ERDF systems (audit No. 2005EE/REGIO/I2/331/1)	December 2005 *(unfinished)*
CF	Management and control systems of the Cohesion Fund	February 2005
CF	DG Regio Cohesion Fund System audit / Public Procurement Audit mission	May 2006
EAGGF	Single Area Payment Scheme and CNDP audit	March 2005 *(unfinished)*
EAGGF	Review of the accreditation on Estonian Agricultural Registers and Information Board	September 2005 *(unfinished)*
EAGGF	Audit mission under Article 7(4) and 9(2) of Reg 1258/99 (audit mission to Estonia on the national application of support measures in the dairy products, intervention storage and food aid sectors)	October 2005
EAGGF	Assignment related to expenditure on rural development financed from EAGGF Guarantee Section, EAGGF Guidance Section and SAPARD	June 2006 *(unfinished)*

Source: NAO (on the basis of data provided by the Ministry of Finance and Ministry of Agriculture)

234. A short overview of relevant observations of completed audits is given below.

235. As a result of the management and control systems audit of the use of the Cohesion Fund, the Commission found the systems in compliance with standards; the effectiveness of the implementation of system was not audited. Observations were made on the failure to notify the Commission of the changes in system in good time, poor readiness of IT systems and separation of obligations (the authority performing the audit and paying authority take orders from the same deputy secretary general of the Ministry of Finance).

236. The Commission's assessment on the management and control systems of the use of the Cohesion Fund was that the management and control systems function as expected but some relevant parts of the system do not function in a sufficiently consistent manner, as frequently or thoroughly as required by regulations. The following observations were made in the course of the audit: management and control systems in three levels are complicated and this should be simplified; documentation is not sufficient (e.g. explanations were based on the employees' memories) or the documents have not been properly classified; it should be avoided that the eligibility date precede the date of adopting official decisions; verification visits should be organised without prior notification.

237. In conclusion, it can be said that even though there is still room for development in improving the systems, the European Commission's assessment of Estonia, based on the completed audits, has been positive.

Main findings on Estonia of the audits of the European Court of Auditors

238. During the programme period 2004–2006, the European Court of Auditors (hereinafter also referred to as ECA) made three auditing visits to Estonia (See Table 9). In addition to auditing, the Court of Auditors has visited Estonia for other reasons, e.g. to introduce the annual statement or special report of the Court of Auditors.

Table 9. Estonia's communication with European Court of Auditors in 2004–2006

	2004	2005	2006
Audits		2	1
Traditional own resources (DAS)		1	
EAGGF Guarantee Section and other agricultural measures (milk quota implementation audit)		1	
Single area payment scheme (SAPS)			1
Introduction of ECA annual statement and special report	1	3	2
Overview of the activities of the ECA		1	
Participation in audit methods and guidelines working group			1
Asking for information, sending the questionnaire	1	5	5

Source: Correspondence between the Court of Auditors and the National Audit Office

In January 2005, the Court of Auditors audited traditional own resources (DAS) and electronic customs clearance system. The main problem identified as a result of the audit was that the Tax and Customs Board had not requested securities as required by the Community Customs Code. According to the Court of Auditors, the absence of a guarantee is a potential threat to the collection of own resources. The ECA suggests that such inspection be carried out and documented regularly. In its letter of reply, Estonia concurred with the results listed by the ECA, and understood the need to require a guarantee and strengthen IT control environment.

239. In November 2005, the Court of Auditors visited Estonia in relation to an audit on milk quota. The audit concerned the implementation of Community rules for milk quota and consisted of inspections carried out at milk producers and dairies. A tentative overview of the observations of the audit has been sent to Estonia, so far there is no final report.

240. In June 2006, a financial audit of the single area payment scheme was carried out in Estonia. The audit comprised inspection of the system of paying authority as well as four random transactions up to the level of beneficiary. A tentative overview of a possible error of form (total sums are missing in the application) and of four substantial errors (overdeclaration of land) has been sent to Estonia.

Infringements in the use of the EU funds

241. Pursuant to the EU regulations, all Member States must notify the European Anti-Fraud Office (OLAF) of frauds affecting financial interests and of other irregularities.

242. In its 2005 management report[4], OLAF has stated as a positive aspect the improvement of cooperation and exchanged of information between Member States, finding, however, that there is still room for development. In its report[5], the European Commission has emphasized that exchange of communication with new Member States is better than with several older Member States.

243. As problematic areas, OLAF mentioned cooperation, delivery of evidence and communication (e.g. insufficient dissemination of information, notification of an infringement several years later). According to OLAF, it is a relevant weakness that there are far to few people employed by the Member States' customs sectors, whose level of experience would allow them to cooperate with OLAF.

244. The most common infringements within the EU reported to OLAF (See Table 10) are administrative by nature and are usually discovered during a routine check of documentation prior to the payment of support. For example, the following problems are mentioned:

- There are non-eligible expenses, documents are incorrect or missing.
- One of the most common infringements is falsification of expense receipts, incl. also showing the expenses to b larger than in reality.
- It was often identified that after using the support some of the recipients of support have only partly completed the project or

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[4] Report of the European Anti-Fraud Office. The Sixth Activity Report for the period 1 July 2004 to 31 December 2005

[5] Annual Report 2005 from the Commission on the Protection of the European Communities financial interests and the fight against fraud. Statistical Evaluation of Irregularities Agricultural, Structural and Cohesion Funds, Own Resources and Pre-accession Funds

has not completed it at all, and falsified invoices have been submitted to verify the expenses.

- Several frauds committed during procurement were identified – manipulation with tendering procedures or their falsification. The use of directed tendering procedure instead of open tendering procedure is also not always justified.

Table 10. Most common infringements in Member States

Description of infringement	Frequency in 2004–2005
Non-eligible expenses	633
Incompliance with rules in the use of support	305
Incompliance with the requirement of second regulation/agreement	291
Missing or incorrect documents	286
Failure to carry out activities	279
Irregular completion	229
Failure to comply with deadlines	179
Documents based on lies or falsified documents	170
Overfinancing	158
Violation of public procurement rules	157
Other infringements	999

Source: Annual Report from the Commission on the Protection of the European Communities' financial interests and the fight against fraud. Statistical Evaluation of Irregularities Agricultural, Structural and Cohesion Funds, Own Resources and Pre-accession Funds; year 2004 & 2005

245. A total of 2259 infringements were identified in Estonia in 2004–2006. Of these, 2216 were infringements of the use of EAGGF Guarantee Section, 37 infringements of Structural Funds and 6 infringements of the use of the Cohesion Fund. More detailed information on the infringements accompanying the use of EU support is given in Table 11.

Table 11. Infringements identified in Estonia regarding the use of EU funds in 2004–2006

	Number of infringe-ments	Amount of support (share of the EU and Estonia) in EEK thousands	Recovered, in EEK thousands	Amount to be repaid to the EC, in EEK thousands
Structural Funds	37	36,375	9,282*	0
Cohesion Fund (incl. ISPA)*	6	5,302	3,445	3,876
EAGGF Guarantee Section	2,216	15,502	12,423	2,927
TOTAL	**2,259**	**57,179**	**25,149**	**6,803**

* According to 31.12.2006, some of the data is to be specified

Source: Ministry of Finance and ARIB

246. Infringements identified in the use of the funds of Structural Funds mostly comprise submission of false information, failure to carry out activities promised in project application, violation of the Public Procurement Act and generation of non-eligible expenses.

247. In relation to the Cohesion Fund, the principal problem has mostly been the inexpedient use of support.

248. Most of the infringements in EAGGF Guarantee Section were due to the difference in the area of the agricultural land as shown in the application and its area in the reality.

249. In 2004–2005, Estonia notified OLAF of 25 infringements (See Table 12) and in 2006 of 22 infringements. The estimated damage arising from all infringements in 2004–2006 amounts to EEK 57 million, approximately EEK 25 million is made up by recoveries. Estonia has approximately EEK 6.8 million worth of obligations to be repaid to the European Commission.

250. Approximately half of all infringements has been committed in the course of implementing the support of the European Agricultural Guidance and Guarantee Fund's Guarantee Section (or CAP). Prevalence of infringements in this area is partly due to the fact that the number of agricultural supports is the largest. The other half of all infringements has been committed in the use of Structural Funds and the smallest part is made up by infringements committed in the use of the Cohesion Fund.

Table 12. Infringements in the use of support in Member States in 2004–2005 (No.)

Member States	EAGGF	SF				CF	TOTAL
		ERDF	EAGGF	FIFG	ESF		
Austria	196	65	7	0	33	0	301
Belgium	114	45	0	3	23	0	185
Cyprus	8	0	0	0	0	0	8
Czech Republic	0	4	0	0	1	6	11
Germany	1,334	1,492	121	20	560	0	3,527
Denmark	106	49	1	4	17	0	177
Estonia	7	2	1	0	13	2	25
Greece	93	221	62	5	50	423	854
Spain	1,362	167	78	24	331	17	1,979
Finland	44	18	8	0	56	0	126
France	1,006	96	5	3	67	0	1 177
Hungary	5	4	16	0	3	1	29
Ireland	187	43	0	4	0	18	252
Italy	201	679	180	46	296	0	1,402
Lithuania	32	0	2	0	0	3	37
Luxembourg	7	1	0	0	5	0	13
Latvia	1	1	9	0	0	1	12
Malta	0	0	0	0	0	0	0
Netherlands	454	25	6	2	91	0	578

Poland	76	6	44	0	20	5	151
Portugal	534	142	212	12	94	28	1,022
Sweden	183	165	12	2	112	0	474
Slovenia	0	0	0	0	0	0	0
Slovakia	0	0	0	0	0	0	0
Great Britain and Northern Ireland United Kingdom	644	270	36	11	202	0	1,163
TOTAL	**6,594**	**3,495**	**800**	**136**	**1,974**	**504**	**13,503**

Source: NAO on the basis of the data provided by OLAF

251. More than a quarter of all EU infringements is made up by the infringements of Germany, which were mainly committed in the use of EAGGF Guarantee Section and European Regional Development Fund. Among the so-called old Member States, the number of infringements is the smallest in Luxembourg and Finland. Of new Member States, Poland and Lithuania have reported the most infringements. Malta, Slovenia and Slovakia have not reported any infringements. Estonia holds the 8th place in the list of Member States who have reported the least infringements in two years. Compared to Estonia, Estonia's southern neighbour Latvia has reported half the number of infringements and the number reported by Lithuania is larger by a quarter.

252. In conclusion, it can be said that when it comes to infringements, Estonia is among the average Member States – in the EU list of infringements, Estonia has been holding the 8th place of 25 Member States for two years. The Member States who have reported a smaller number of infringements than Estonia are for example Luxembourg, Latvia, and Czech Republic. Of Structural Funds, Estonia has so far had the most problems with the European Social Fund that has allocated EEK 1.2 million to Estonia. Infringements in the use of Structural Funds also create the biggest estimated damage, EEK 176.7 million. As the payment of EU support falls for the most part to a later period in Estonia, all potential infringements have not been discovered and it may happen that more infringements shall be identified and bigger damage created.

NAO audits on the use of EU funds in Estonia

253. In 2004–2006, the NAO carried out four audits on the use of EU funds. The summaries of audit results are given below.

The activity of the Ministry of Finance in accrediting the Intermediate Bodies and Final Beneficiaries

254. In its Regulation No. 81 of 22 March 2004, the Government of the Republic decided that management and control systems must be audited in Structural Funds' intermediate bodies and final beneficiaries. The authority performing the audit was the Ministry of Finance. On the basis of audit results, the Minister of Finance decided on the accrediting of said authorities, i.e. whether to consider the authorities eligible for processing Structural Funds' applications and adopting financing decisions in the 2004–2006 programme period.

255. As accreditation is a relevant preventive control measure, the NAO considered it necessary to audit the accreditation system and, if possible, make recommendations for its improvement.

256. According to the NAO, the Ministry of Finance had created prerequisites for the compliance with accreditation and control measure, but it was necessary to supplement its performance. The NAO did not consider the accrediting decisions unreasonable, but was of the opinion that it was not possible to see the substance of decisions retroactively, as the accreditation process has been documented insufficiently. The NAO's main recommendations to the Minister of Finance on how to improve the accreditation process in the next programme period were as follows:

- If the applications' processing system's main aspects remain the same and the same authorities shall be accredited for the next programme period, take into account all results of relevant audits carried out in the previous programme period, so as to assess and test the actual functioning and implementation of management and control systems as well as their compliance with requirements.
- Instead of dividing the observations made regarding the management and control system in the course of the accreditation audit into three, divide them into two, e.g. into observations affecting the management and control system and into those not affecting the system. This relevantly simplifies the assessment and helps to avoid the possibility of interpreting observations differently.
- Upon making accrediting decisions, take into account the relevant observations made in the course of management and control system audit, or give reasons when not doing so. Document the work done in the course of shaping the accrediting decision, incl. assessment of observations provided in the report for accrediting audit and check of compliance with the recommendations provided in the final report of the accrediting audit. This enables the Ministry of Finance to give reason for the accrediting decision and certify it, if necessary.
- Take minutes of all the meetings regarding accrediting decisions in the Structural Funds' and Cohesion Fund's intermediate bodies and final beneficiaries and call a new meeting if new circumstances occur that may influence accrediting.
- If the Ministry of Finance continues to consider necessary (e.g. due to temporary huge workload) to buy in auditing service, only single audit procedures should be bought, not the entire audit procedure. Assessment on the management and control system must be given by the Financial Control Department, based on the work of external auditors. Thus it is possible to avoid a conflict with the regulation of the Government of the Republic, pursuant to which only the performance of a special audit can be ordered from an audit company.
- Develop general principles for involving an audit company for performing special audits and single audit procedures, in order to

ensure the provision of quality service. Among other things, require a confirmation in the agreements concluded with audit companies that the work shall be performed pursuant to the Auditors' Code of Ethics; audit procedures shall be carried out in compliance with international auditing standards and that the Ministry of Finance shall receive a report on all observations, etc.

257. **The Minister of Finance** concurred with almost all recommendations of the NAO. The Minister did not concur with the recommendation to divide the observations for the sake of clarity into those affecting the management and control system and those not affecting it, because it violates the auditor's requirement of impartiality. The NAO specified that it is the duty of the auditor to assess the degree of difficulty of observations regarding management and control systems and it should not be understood as dividing observations into those affecting the accrediting decision and those not doing so.

Audit "European Social Fund measure 1.3 "Equal opportunities in the labour market""

258. The aim of the audit was to assess the current situation of implementation of measure 1.3 and give and assessment on the compliance with recommendations on the improvement of control systems provided in previous audits, as well as an assessment on the organization of control system in the final beneficiary and performance of projects in the sample corresponding to what was planned.

259. The audited authorities were the Ministry of Social Affairs and Labour Market Board. In the Ministry of Social Affairs it was assessed whether the system ensures the separation of obligations and prevents the conflict of interests in the implementation of projects of both the Labour Market Board and its structural units. It was also inspected if the projects of employment services had been reassessed pursuant to new Regulation in the autumn of 2005. The audit in the Labour Market Board comprised assessment of the compliance with requirements of the current rules of procedure and whether they ensure the processing of the application for support without impediments as well as the lawful and effective implementation of structural aid. Rules of procedure were compared, and whether a change in them takes into account the recommendations of previous audits.

260. The following observations were made in the course of the audit:

- Approved projects are constantly changed. As the explanatory memorandums for project budgets require that the calculation and necessity of expenditure be explained very accurately by types of expenditure, there is an indispensable need to change the expenditure types during the project. In the course of auditing three projects it was identified that their budget was changed after the submission of payment applications when it became clear that all expenses are not eligible. There were also problems with the fact that not all changes to the budget could be observed in the Labour Market Board's operative system during the audit.

- Checking of payment applications takes a lot of time. The six-monht cycle for submitting a payment application and constant changes in rules retroactively have resulted in a large volume of additional work for both the implementers of project and checkers of payment applications. Checking the compliance with the Public Procurement Act is not carried out.

- There were weaknesses in organizing procurement for project No. 132: misleading dates for the recognition of tender as successful, failure to submit a required delaration to the Public Procurement Register, there were shortcomings in the management of documentation for carrying out public procurements and verifying their organisation, the organization of proposals as to the amount of fee was inaccurate as was making a decision regarding the conformity assessment for the eligibility of accounting records of the project.

- The procedure for recoveries is insufficient. It remained unclear how to operate if it is only discovered later that expense receipts are not in compliance with the requirements or if planned/made expenses are not eligible. In this case the there are problems with recording the recovery in the register of structural assistance. Said register includes modules for both infringements and recoveries but the Labour Market Board did not complete them on the reason that they were not functioning.

- Submission of performance indicators is unclear. Calculation principles of the projects' performance indicators can be interpreted in several ways. Due to ambiguous interpretation one cannot always be certain that the performance indicators provided in monitoring reports also correspond to the real situation.

- Some project money could be re-distributed. The sum allocated to project should be reduced at the right time if necessary (e.g. if performance indicators have been met but part of the budget remains unused), and the unused funds should be distributed to new projects. Continuation of projects in order to fully use the planned budget, may bring about the threat that the project's management and operating expenses are increased, but the number of the members of the target group participating in the project will not be increased considerably.

261. **The Minister of Social Affairs** stated in his reply that he took the recommendations of the NAO into account and in the future it will be proceeded primarily from achievement of the project goals when considering the extension of the projects. Application round IV will be declared at the end of 2006 or at the beginning of 2007 for using the budget funds released from the completed projects.

262. In his reply **the Minister of Finance** stated that the management authority inspects the compliance of the data of the information system with the actual situation once a month. Any differences in the data are brought to the attention of the final beneficiaries. The Minister also stated that the paying authority has drawn up instructions for repayments.

263. **The Acting Director General** of the Labour Market Board replied that simplified rules of procedure for processing payment applications have been drawn up and the ESF started applying them as of September

2006. According to these rules it must be made certain, among other things, whether public procurement has been carried out correctly. In addition, detailed instructions for drawing up monitoring reports have been developed and rules of procedure for amendment of the project budget have been approved.

HASCO project of the European Commission in the rural municipality of Sonda

264. The purpose of the audit was to receive a response as to whether the objectives of the environmental project “Oil-Shale Semi-Coke Processing into Soil Improver, Soil Improver Used to Stabilise Slurry and Restore Damaged Soils for Foresting Mainly with Hybrid Aspen” (HASCO project) were met; which rules of agreement the rural municipality of Sonda had violated that brought about the obligation to repay the funds received from the European Commission; how to prevent such situations in the future.

265. The audit focused on examining and analysing the activities and documents of HASCO project financed by the European Commission.

266. The following observations were made in the course of the audit:

- the project management work groups did not function in reality, which is why there was no control over the performance of tasks;
- the conflict of interests was not prevented in the course of the project (e.g. the representative of the rural municipality participated in the project as the contractor);
- partnership agreements were signed for the rural municipality by an unauthorised person;
- partnership agreements had not set the requirements for the form, preservation and presentation of source documents; some parts of partners’ tasks were not established; the agreements did not provide for the fact that if a partner wishes to withdraw from the project, the partner must continue to carry on its duties until a new partner is found; the procedure set in partnership agreements for submitting fixed reports and reimbursement of expenses was not complied with;
- documentation verifying the implementation of the project was not preserved; bills of costs partially lacked references to project’s tasks; the documentation giving reason for the choice of suppliers was missing;
- project’s partners did not submit required reports to the rural municipality;
- project’s partners ignored the respective prohibition and acted as beneficiaries under the project, or as sub-contractors or suppliers for other partners;
- all partners of the project were not financially suitable or did not possess the necessary know-how to carry out the project’s tasks;

- project's budget was not taken into account upon making expenses;
- the report submitted to the European Commission was insufficient: project results provided in the report had not been verified with source documents and the report recorded expenses that had not been made or for which there was no evidence.

267. The audit of the NAO confirmed the circumstances on the basis of which the European Commission asked the rural municipality of Sonda to repay the allocated funds.

268. **In the letter of reply** to the draft audit report of the NAO, the rural municipality mayor of Sonda concurred with the NAO's assessment and added that a plan of action for meeting the obligations of the European Commission is being compiled.

269. **In the letter of reply** to the draft audit report of the NAO, the Minister of Finance promised to present the draft acts regulating the financial management and resolution of the insolvency of local governments to the Government of the Republic by 1 October 2006.

270. **The Supervisory Board of the Environmental Investment Centre** analysed the necessity of the supervision over the use of the loans given to local governments and found that in order to manage the risk of the recovery of allocated money, the Environmental Investment Centre must carry out a financial analysis of all loans.

Development of waste water treatment in rural areas with the support of the Cohesion Fund's projects

271. The National Audit Office examined the work of state agencies and local governments in launching the first water management projects financed through the Cohesion Fund during the 2004-2006 programme period of the European Union. Three projects – those for the Western islands, the Matsalu ecological reserve and the Emajõgi and Võhandu Rivers – were audited in terms of the success of their preparation and instigation and the sustainability of the water management systems developed as a result. The audit incorporated 63 local authorities and seven regions of water companies established by them.

272. According to the National Audit Office, Estonia is unable to ensure sufficient waste water treatment in all settlements by 2010, which may result in infringement proceedings by the European Union. Waste water treatment supported through the Cohesion Fund's projects has not been organised in a sustainable fashion, with the price of water and sewerage not incorporating all costs and there being lingering uncertainty regarding the future administration of new structures.

273. The following observations were made in the course of the audit:

- Too little funding is planned for the improvement of water management systems. According to the calculations of the Ministry of the Environment, it will cost 18 billion kroons to bring waste water management in all settlements into conformity with European Union regulations between 2007 and 2013, but only 12 billion kroons is currently planned for the development of water management and waste treatment in this period. Furthermore, projects from the second Cohesion Fund programme period will not be completed in time to fulfil the obligations of the European Union's urban waste water directive by 2010.

- There are problems with the involvement of local governments in instigating projects. If a local government has no interest whatsoever in participating in a project, the Ministry of the Environment currently has no power to oblige them to do so. Several local governments are unable to take part in projects as their ability to cofinance them (including through loans) is restricted.

- There are shortcomings in both the financial analyses of projects and their technological solutions. Ineffectual applications and confusion in assessing environmental impact led to delays in launching projects: the reviewing of applications by the European Commission took longer and additional terms and conditions were placed upon funding decisions which the state would have to fulfil before the funds were allocated.

- The sharp rise in building costs felt as a result of the delays in the projects has increased the need for additional state financing. In the last couple of years, the cost of building tenders for the environmental sector has gone up by an average of 1.8 times. It is calculated that an additional 2 billion kroons will need to be found between 2008 and 2011 to compensate for the increased cost of the six Cohesion Fund projects currently under way. As this amount cannot simply be covered either by increasing the contribution of local governments or from the budget of the Environmental Investment Centre, the projects will have to be supported through the state budget.

- The organisation of waste water treatment in rural areas with the support of larger Cohesion Fund projects will not guarantee the sustainability of the sector, as not all costs are being taken into consideration in determining the price of water and sewerage services. As a result, the revenue earned from these rates will not be sufficient for renovation and modernisation in the future. Thus a situation could arise where the state will have to cover the cost of exchanging old and damaged equipment, since local governments and water companies will not have generated enough money to do this themselves .

- The water companies that were audited are able to cope at a satisfactory level with the administration of water management projects, but none of them has developed a business plan meeting the necessary criteria in terms of how to guarantee the further management of public water supply and sewerage systems that have been created once a project has reached its conclusion. As such, the management of these structures may prove in future to be considerably more expensive than forecast. It also remains largely unclear who will use the equipment and provide its services to consumers once the Cohesion Fund projects are launched, and whether common prices will be established in a region or set by individual local governments. The NAO also found that neither the success of the implementation system of the Cohesion Fund's projects nor the effectiveness of investements has been sufficiently assessed. Current knowledge of the made investments and their impact is insufficient and divided between different authorities. Collected data is not usually mutually compared, it is not analysed and used for allocating new investments: e.g. for developing assessment criteria for the quality of project applications and organization of their assessment, as well as for the general management and surveillance of water management.

274. In reply to the recommendation of the NAO to draw up by the end of 2007 an overview of the status of water management of local governments and Estonia's ability to fulfil the EU's requirements, the Minister of the Environment found that he has a general overview of the funds required for the implementation of the directives and that it will be updated by the end of 2007. The Minister of the Environment is of the opinion that the local governments must have an overview of the financial needs of rural municipalities.

275. Both the Ministry of Finance and the Ministry of the Environment are of the opinion that it is not the state's duty to assess the financial capacity of local governments in implementing the Cohesion Fund's projects, but the local governments themselves should be responsible for it.

276. In response to the NAO's proposal to transfer the role of approving the price of water supply and sewerage services from local government councils to another agency, either already in existence or to be especially formed for that purpose, the Minister of the Environment confirmed that a legislative amendment is currently being initiated that is designed to resolve the problems associated with the establishment of water prices. However, the Minister did not specify how these problems will be resolved. The Association of Estonian Cities does not agree to any change to the competence of approval of water prices. The association recognises the potential for the price of water to rise, and draws attention in its response to the social problems this could lead to.

277. Although the Minister of the Environment recognises the same problems as the NAO regarding the implementation of the Cohesion Fund water projects, the Minister found that the Ministry of the Environment cannot carry out various recommendations because their implementation lies within the competence of the local governments.

/signed digitally /

Juhani Lemmik
Chief Auditor
Audit Department I

Recommendations of the NAO and replies of the Minister of Finance and the Minister of Agriculture

In its special report, the NAO made several recommendations to the Minister of Finance and the Minister of Agriculture. The Ministers sent their replies to the NAO's recommendations on 27 August 2007 and 30 August 2007, respectively.

General comments of the Ministers regarding the special report

Minister of Finance: In addition to replying to the recommendations of the NAO, we wish to provide some additional comments as to the contents of the special report.

We bring attention to the fact that the statement "The audits only assess the functioning of management and control systems and accuracy of expense receipts. They do not pay attention to whether the support is used pursuant to objectives and effectively" given on page 2 of the special report is not truthful. We consider it necessary to further explain the substantial nature of the audit of expense receipts. Said audit does not only inlude the audit of expense receipts as its name may suggest, but its scope is wider. It includes the analysis and assessement of the life cycle of the entire project.

According to the methodology of the audit of expense receipts, the scope inludes:

- inspection of the implementation of the project's activities;
- comparative inspection of expenses applied for payment, expense receipts, documents verifying payment and other evidence;
- inspection of the eligibility of expenses (incl. compliance with the document "Estonian National Development Plan for the Implementation of the EU Structural Funds – Single Programming Document for 2004-2006" or other relevant programme documents and rules of eligibility);
- existence of own funds the recipient of structural aid and inspecton of proportions of structural aid and own funding;
- inspection of the compliance of the use of structural aid and own funds with the EU and national legislation.

The purpose of the audit of expense receipts is to analyse and assess (general rules for internal audit of authorities of executive power, additional requirements for internal auditor upon his recruitment and terms and procedure for auditing the allocation and use of structural aid as well as the procedure for preparing and submitting the declaration of the winding-up of assistance, § 16(2)):

1) the existence of financial reports and expense receipts related to the allocation and use of structural aid and the existence, accuracy and relevance of other documentation verifying the use of structural aid in authorities regulating the allocation and use of structural aid as well as in the final recipient;

2) compliance of accounting with current legislation of the authorities regulating the allocation and use of structural aid as well as of the final recipient;

3) possibility of verifying the transactions concluded during the project pursuant to the documentation the transactions were based on, or the existence of audit trail;

4) eligibility of declared expenses and their correspondence to the performed activity's volume and contents;

5) compliance of allocation of structural aid to legislation and its purposeful use pursuant to objectives and requirements set in the application for structural aid and decision acceding the application for aid;

6) allocation of structural aid in prescribed amount and in time and existence of own funding.

Check-lists (work papers) and final reports of audits of expense receipts have been drawn up on the basis of the same structure.

NAO: By the commented statement of the Minister of Finance, the NAO wished to state that no performance audits are carried out, i.e. the achieved results and impact is not assessed in a wider scope.

Minister of Finance: A statement "Compared to compliance with formal criteria, the European Commission pays less attention to the attainment of objectives set by the support" can be found on page 2 of the report. It is difficult to concur with such a statement. From Estonia's cooperation experience with the Euriopean Commission we can conclude that the EC considers the achievement of objectives very important as well as the development of effective management and control systems to that end. Thus, a set of rules has been established, which in the best possible way would ensure the attainment of objectives. These are not merely formal criteria but principles on how to ensure the existence of functioning management and control systems in Member States in order to achieve the attainment of the objectives of structural aid.

NAO: The NAO concurs with the opinion of the Minister of Finance that the EC considers the development of management and control systems very important. The NAO feels that only the development of systems is not sufficient for ensuring the attainment of set objectives. So far, the EC has largely focused only on inspecting the compliance with rules in Estonia.

Minister of Finance: In item 48 on page 16, we suggest to change the wording of the paragraph, for better understanding, as follows: "In addition to abovementioned declaration, the audited authority must submit to the European Commission by 30 June of each year a description of the national organization of the auditing of support and overview of the audits carried out in the previous period, which gives an aggregated assessment on the functioning of management and control systems. With the mentioned overview a description of management and control systems drawn up by the management authority shall also be submitted to the European Commission (See Figure 2)."

NAO: The NAO took the adjustment into consideration.

Minister of Finance: It is mentioned on page 37 that the audited authority has ordered three audits from external auditors in addition to some accrediting audits. In reality, two audits were ordered and two joint audits carried out, in the course of which audit resource was bought in from audit companies but the performance of an audit as a whole was not ordered.

NAO: The NAO took the adjustment into consideration.

Minister of Finance: Item 51 of the report refers to a regulation that has expired. Said regulation has been replaced by Regulation No. 22 "Procedure and forms of reports for submitting financial reports on allocation and use of structural aid and for the period of 2004–2006" of the Government of the Republic of 2 April 2007.

NAO: The NAO added a respective reference to the report.

Minister of Finance: We also find that in current state the summary of the report does not sufficiently convey the contents of the report itself. In order to give an overview to the members of the Parliament and to the public of the implementation of EU support in Estonia, the summary must, in addition to shortcomings, also record fields or topics, where no shortcomings were identified and which, in the NAO's opinion, were organised and function of the Government of the Republic of 2 April 2007.

NAO: The NAO's positive assessment and its scope is given in half-bold in the report's first paragraph of conclusion.

Minister of Agriculture: Thank you for drawing up the capacious and informative special report "Special report on the use of European Union financial support in Estonia 2004–2006". During the lengthy period of preparing the special report, the Ministry of Agriculture has repeatedly submitted comments to various versions of the draft special report (last comment sent in 17.07.2007 to Krista Zibo via e-mail).

It is relevant to note that various financing schemes are used for financing the measures of organization of market of common agricultural policy (CAP) and measures of rural development plan (RDP). The measures of organization of market of the CAP are financed entirely from the EU funds (except for school milk support, apiculture programme and promotion measures) and the measures of the RDP are financed through co-financing. Arising from this, the EU establishe rules regarding the support for organization of market of the CAP, which the Member States must comply with.

These various approaches to support measures should be taken into account upon preparing the special report as a whole. Additionally, the types of rural development support and other support measures accompanying the CAP as well as applicants should be listed in the report, which would provide a better overview of the ratio of identified errors in relation to the number of support and beneficiaries. Comparison of the same indicators with other authorities processing the support would improve the contents of the report and would enable to explain the background system for CAP support.

As already mentioned, it is a report that provides an overview and describes the respective capacious filed as much as it is necessary to understand the problems. According to the NAO, such approach gives the reader a clearer overview. The NAO also finds that collection and processing of analytical information as well as its presentation to the public is the task of the Ministry of Agriculture.

General comment of the Minister of Agriculture: Throughout the report, the term "Uniform Agricultral Policy" has been used; the correct term would be "Common Agricultural Policy".

NAO: The draft special report was checked for factual errors in the Ministry of Agriculture and ARIB. Unfortunately, it was not mentioned that the draft uses a wrong term for this definition. Naturally, the NAO considers it relevant that a single term b e used for the defitniton.

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
Submission of state declaration 37. Recommendation to the Minister of Finance: Consider submitting a state declaration to the European Commission on the fact that the management and control systems implemented in Estonia for Structural Funds and the Cohesion Fund are in function and said EU support has been used in compliance with the established rules. **(items 29–36)**	**Response of the Minister of Finance:** In the beginning of 2010 at the latest, the audit authority will submit to the European Commission a statement on winding-up of financial support for the period 2004-2006 and it will include an assessment of the entire period and each individual fund. The conducted management and control system audits have assessed whether the implemented management and control systems are in function and the EU support has been used in compliance with the established rules. Respective system audits have been conducted at least once in three years in each agency and the annual summary (conclusion) has been included in the Annual Report on Structural Funds Auditing. Pursuant to Article 62 of the Council Regulation No 1083/2007, the audit authorities of all Member States are required in the period 2007-2013 to submit to the Commission a summary report on the findings of completed audits and an opinion as to whether the management and control system functions effectively, so as to provide reasonable assurance that statements of expenditure presented to the Commission are correct and the underlying transactions are legal and regular. It means that in the new programming period, submission of the annual opinion to the European Commission is the responsibility of the audit authority. Preparations to develop a methodology

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	for this confirmation have been already started. When developing the methodology, the Ministry of Finance will also analyse whether submission of a declaration in a similar form would be justified and possible before closing the programming period 2004-2006. We agree that structuring the internal assessment process is a task that involves much responsibility and requires many resources. It implies good cooperation between various parties in order for the national declaration to provide maximum benefit for the Commission and Court of Auditors and to achieve the objective stated by Siim Kallas, Vice-President of the Commission, that the Court of Auditors would be able to approve the EU budget without reservations.
Confirming the purposefulness of payments 56. Recommendation to the Minister of Finance: Establish a legal framework necessary for issuing confirmations and establish control measures to be implemented prior to submitting the confirmation. This would also require an analysis, whether the system of issuing confirmations needs improvement. **(items 49–55)**	**Response of the Minister of Finance:** We would like to point out that, in addition to the confirmations issued by the auditing authority that have been discussed under item 1 of this response, there are currently additional mechanisms for gaining assurance that the granting and use of the support is adequate. A separate procedure has been established by the Ministry of Finance Regulation in order to gain assurance of the eligibility of stated expenditures and functioning of the management and control systems. “In the beginning of 2010 at the latest, the auditing authority will submit to the European Commission a statement on winding-up of financial support for the period 2004-2006 and it will include an assessment of the entire period and each individual fund. The conducted management and control system audits have assessed whether the implemented management and control systems are in function and the EU support has been used in compliance with the established rules. Respective system audits have been conducted at least once in three years in each agency and the annual summary (conclusion) has been included in the Annual Report on Structural Funds Auditing. Pursuant to Article 62 of the Council Regulation No 1083/2007, the auditing authorities of all Member States are required in the period 2007-2013 to submit to the Commission a summary report on the findings of completed audits and an opinion as to whether the management and control system functions effectively, so as to provide reasonable assurance that statements of expenditure presented to the Commission are correct and the underlying transactions are legal and regular. It means that in the new programming period, submission of the annual opinion to the European Commission is the responsibility of the audit authority. Preparations to develop a methodology for this confirmation have been already started. When developing the methodology, the Ministry of Finance will also analyse whether submission of a declaration in a similar form would be justified and possible before closing the programming period 2004-2006. We agree that structuring the internal assessment process is a task that involves much responsibility and requires many resources. It implies good cooperation between various parties in order for the national declaration to provide maximum benefit for the Commission and Court of Auditors and to achieve the objective stated by Siim Kallas, Vice-President of the Commission, that the Court of Auditors would be able to approve the EU budget without reservations.” (The latest version is dated 2 April 2007). Consequently, the required legal framework for confirming the eligibility, incl. regularity, of the expenditures already exists (a similar procedure has been also established for the period 2007-2013). According to this procedure, assurance that expenditures are eligible is gained and confirmed in stages at each level of the implementing system, from the level of the final beneficiary through the intermediate body and managing authority to the paying authority. The final confirmation to the European Commission is issued by the paying authority. The control procedures with regard to expenditures as well as the management and control systems are carried out at each level according to the respective competencies and responsibilities. In order to simplify the procedure of confirmation, the format of the confirmation (‘statement’) was changed in April 2007 so that it would include the basic checklist for each authority. This specifies the exact procedures for which the confirmation of performance and appropriateness is required. The logic of procedure dictates that, when issuing confirmations, the authorities have to rely mainly on their regular control procedures. At the level of the control of final beneficiaries, the Ministry of Finance has been issuing

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	respective instruction materials already since 2003. In order to harmonise the procedures for issuing and documenting confirmations of the intermediate bodies, the Ministry of Finance issued on 25 June guidelines for the intermediate bodies for the organisation of supervision over final beneficiaries. **Commentary by the NAO:** The NAO in its recommendation considered the objective that issuing the confirmation should not be approached as a formal procedure and that specific prior control procedures should be established. If no other means suffice, the procedure for issuing confirmations should be established by a Government of the Republic Regulation. The NAO believes that if the established new procedure takes account of the above considerations, the main shortcomings have been eliminated.
Improvement of the register of structural assistance 72. Recommendation to the Minister of Finance: Ensure recording the audits of the management and control systems in the register of structural assistance. This change would enable to save time and conduct a systematic analysis of all information. **(item 71)**	**Response of the Minister of Finance:** It is true that the reports and data of the management and control system audits are not included in the register of structural assistance. This register is a project management system where all data have been entered by individual projects and the purpose of the register is to facilitate project management and preparation of reports and statistical data for the projects. As the management and control system audits are not related to specific projects, the information obtained from these audits cannot be recorded in the register. This does not mean that there is no overview of the management and control system audits. All management and control system audits are registered in the audit plan prepared by the auditing authority and audit reports are given to the audited body itself, as well as the auditing authority and the managing authority. The reports of the management and control system audits can be classified by the intermediate bodies and final beneficiaries, because each audit report is associated with a specific audited body. The Ministry of Finance (managing authority) also systematically verifies the implementation of the recommendations made in the course of the management and control system audits and, consequently, has a good overview of the elimination of shortcomings. It should be also said that the number of the audits of the management and control systems cannot be large (compared to the number of audits at the level of projects) and this is the reason why it would not be economically feasible to register them in a separate information system or to develop a separate audit report management module in the register of structural assistance.
Evaluating the effectiveness of support 74. Recommendation to the Minister of Finance: Assess more the cost-effectiveness of the use of support and attainment of objectives. Consider whether it would be necessary to require the internal auditors of intermediate bodies and final beneficiaries to partly specialize in performance audits, so as to periodically assess the cost-effectiveness of the use of support. **(item 73)**	**Response of the Minister of Finance:** Structural assistance has been available in Estonia since spring 2004, i.e., slightly longer than for three years. As Estonia acceded to the European Union in the middle of the programme period (the programme period itself lasts for seven years, i.e., 2000–2006) and mid-term appraisal of the programmes had already been completed in Europe, there were no mid-term objectives established for the use of structural instruments. Pursuant to the Regulation laying down general provisions on the Structural Funds (Council Regulation No 1260/1999), the Member States may use the structural instruments for up to two years after expiry of the programme period, i.e., until the end of 2008 in the case of the period 2000-2006. As support payments can be made until the end of 2008, the final assessment of the achievement of objectives and performance could not be made before that time. Therefore, the number and extent of studies and evaluations directed at measuring performance has been moderate so far, but some such studies and evaluations are conducted as an input in the planning for the period 2007-2013 and some performance evaluations are conducted routinely. For example, the State Chancellery has already conducted a performance and impact assessment of the NDP measure 1.4 ‘Enhancing Administrative Capacity’, there has been some assessment of the impact of investments on Estonian fisheries, and a study of the results of the measure 1.3 ‘Inclusive Labour Market’ organised by the Ministry of Social Affairs is currently underway. The Enterprise Estonia has organised an assessment of the impact of enterprise support measures and continues follow-up evaluation of the setting-up aid, which includes questioning all recipients of the setting-up aid three times within three years after they received the aid. Furthermore, many measures require follow-up reports on the long-term results of the projects and they are used for regular analysis.

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	However, we share the opinion of the NAO that the evaluations and studies of the performance will become increasingly topical over the next two years. We would also like to point out that the audit function currently already support measuring the performance. The performance of using the support is evaluated in the current period in the course of the audits of expense receipts pursuant to the guidelines of the European Commission and the methodology prepared by the auditing authority, and it will be audited in the new period also as part of project audits. Based on the fact that the use of support is sufficiently covered with audit procedures arising from the EU and domestic legislative requirements that also include evaluation of cost-effectiveness, the auditing authority does not see a need to impose on the internal auditors of intermediate bodies and final beneficiaries the obligation of conducting performance audits. The internal auditors have the opportunity to add performance audits to their work schedules according to the results of risk assessment. For the period 2007-2013, the auditing authority will submit to the Commission an audit strategy within nine months after approval of the operational programmes and it will specify the sampling methodology and an initial auditing plan. The internal auditors are not under the obligation to audit structural assistance in the period 2007-2013. The auditing authority will prepare a structural assistance work schedule in each year and the internal auditors will be involved in this process.
Assessment of the external auditor on the purposeful use of the support 104. Recommendation to the Minister of Agriculture: Consider ordering from an external auditor an annual assessment on the purposeful use of support paid on the basis of the Common Agricultural Policy. This may also be carried out in the course of the annual report certification audit. **(items 100–103)**	**Response of the Minister of Agriculture:** We would like to point out that a clear differentiation should be made between different types of support and purposefulness of the use cannot be assessed in the case of all CAP support measures. For example, the purpose of direct payments is not supporting certain future activities of the farmer (such as investment support for purchasing a tractor) but compensating the farmer for the expenses from agricultural activities in the economic unit (based on area in hectares or cattle number) in order to offset price fluctuations and increase the competitiveness of the farmer. In such case, it is possible to evaluated whether the amounts paid by the ARIB were paid according to the rules and for the intended purpose (support was paid for actual livestock and land, which has been maintained as required). In addition, the report does not enable clear understanding of the justification behind the recommendation of the NAO. The scope of the certification audit has been established by Article 5 of the Commission Regulation No 885/2006. Pursuant to this Article, certification audit also includes compliance checks. Consequently, the scope of the certification audit includes an assessment of the regularity or purposefulness of the activities (incl. payments) of the paying authority (ARIB). The Ministry of Agriculture believes that the compliance tests performed during annual certification audits are sufficient in case of all types of support. In the case of support where the support funds are allocated for a specific purpose, the ARIB checks prior to or after payment of the support the performance of the supported activity, i.e., the purposeful use of the support. In the case of support where preservation of certain conditions during a specific time period is required (e.g., a commitment period of five years in the case of agri-environmental support), the paying authority verifies the performance of the obligation randomly during the commitment period. The certification audit, in turn, confirms that the control system of the ARIB complies with Community rules. **Commentary by the NAO:** The NAO has described the CAP support in more detail in items 1-27 and considers it important to point out that the Special Report is a generalisation. In our recommendation, we emphasised the need to evaluate the purposeful use of the support. Naturally, the recommendation to evaluate the purposefulness of the use of support applies to the types of support where evaluation of purposefulness is possible. The NAO does not share the opinion of the Minister of Agriculture on the scope of the certification audit. Article 5 (3) of Commission Regulation No 885/2006 states that the certification body shall draw up a certificate stating whether it has gained reasonable assurance that the accounts to be transmitted to the Commission are true, complete and accurate and that the internal control procedures have operated satisfactorily. In the resulting practice, the Commission receives an assessment on the accuracy of the annual report, including an evaluation of the part of the internal audit system

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	that concerns the design and preparation of the report. The main objective of the respective compliance tests is to identify whether that specific part of internal audit system operates or not, i.e., to find out whether the financial information in the report is accurate (see also item 101 on the current practice). It is good in the opinion of the NAO that the ARIB has created an internal audit environment where the purposeful use of the support is checked randomly. However, the NAO considers it important that the same would be assessed by an independent external auditor. The NAO thinks that this is particularly necessary in order to gain assurance within the country.
Development of databases 110. Recommendation to the Minister of Agriculture: Ensure that the ARIB would use and develop databases created for getting a full overview of the implementation of support. This would enable to systematically collect information on the implementation of support, analyse it in various ways and, as a result, strengthen the management and control systems and plan auditing operations in a better and more efficient manner. **(item 109)**	**Response of the Minister of Agriculture:** Pursuant to the EU CAP Implementation Act, a register of agricultural support and agricultural parcels has been created ant it is used to cross-check the support. The ARIB is currently processing 47 different support measures. Different support groups are processed in a special processing program developed specifically for the respective support group. Necessary information queries can be made at any time from the databases of the programs of different measure groups. We agree with the opinion of the NAO that existing databases should be used and developed in order to get a full overview of the implementation of support. The databases can be developed and made more flexible as far as permitted by the available financial resources.
Performance of control functions 115. Recommendation to the Minister of Agriculture: Ensure that the internal auditors of ARIB would organise random audits in the inspection bodies in order to gain assurance that the delegated control tasks have been accurately and materially performed. In the case of inspection bodies conducting the required inspections on the basis of their own statues, establish a system for issuing a confirmation on their activities to the paying agency. **(items 111–114)**	**Response of the Minister of Agriculture:** We would like to point out that all the inspection bodies have been mentioned in the EU CAP Implementation Act. The duties of the paying agency (ARIB) and delegated duties of the inspection bodies (TCB, VFB and ARC) in the implementation of the market organisation support have been established by the Government of the Republic Regulation No 210 of 16 August 2007 on 'Specific Procedure for Cooperation between a Paying Agency and Inspection Bodies' (revoking the previous Government Regulation No 160 of 29 April 2004). The other inspection bodies perform their inspection duties on the basis of other acts. The work of the ARIB should be based on Commission Regulation No 885/2006 that requires accreditation of both the paying authority and other agencies. Evaluation of the delegation of functions by the certifying body was based in the period 2004-2006 on the Commission's *Guideline N°9 – Delegation of tasks to other bodies or services and Guideline N°10 – Physical examinations*. Pursuant to the accreditation conditions provided by the Commission Regulation 885/2006, the paying authority shall ensure that the respective body has effective systems for ensuring that it fulfils its responsibilities in a satisfactory manner. Assurance that the procedures of the other bodies comply with the accreditation conditions is achieved primarily through coordination of the procedures with the ARIB. In addition, the ARIB supervises the work of the delegated bodies in the following manner: A responsible official of the ARIB reviews the checklists of inspections performed by the delegated bodies. The officials of the ARIB can always participate in the inspections conducted by the delegated bodies to gain assurance that the delegated bodies follow their own procedure rules. In addition, pursuant to the Commission Regulation 885/2006, the paying authority shall review on a regular basis the functions delegated to confirm that the work performed is of satisfactory standard and that it is in compliance with Community rules. Pursuant to the Government of the Republic Regulation No 210 of 16 August 2007, the ARIB shall by 30 November annually define and rank the risks associated with the relevant bodies in cooperation with the delegated inspection bodies. Consequently, the ARIB submits the audit topics to the inspection bodies as the basis for the preparation of the annual audit schedule. The inspection bodies submit to the ARIB their audit schedules for the year. After completion of the audit in the delegated body, the findings of

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	the audit should be submitted to the ARIB. These procedures help to ensure supervision over the delegated bodies. Due to the specific nature of the inspections conducted by the delegated bodies, the ARIB takes into account the findings of the internal audit of the respective delegated body and, if necessary, the internal audit department of the ARIB itself conducts audits in the delegated bodies. During the period 2004-2006, the internal audit department of the ARIB reviewed the inspection activities of the Agricultural Research Centre in the framework of the audit of the intervention purchase of grains. In the new financing period, the internal audit department of the ARIB will conduct readiness audits in all new delegated bodies. Commentary by the NAO: Despite fact that the legislation (both EU and domestic) does not require conduct of audits in the mentioned inspection bodies, the NAO believes that the procedures described by the Minister of Agriculture are insufficient to ensure supervision over the regular and material performance of the delegated inspection functions. The NAO maintains its position and believes that a system of issuing confirmations on their activities to the paying authority should be established in the inspection bodies that conduct the required inspections on the basis of their own statutes, and the relevant domestic legislation should be adjusted for that purpose if necessary. Currently, such system has not been created and it is not required by legislation.
Exchange of information with the Agricultural Register and Information Board 118. Recommendation to the Minister of Agriculture: For the purpose of monitoring the activities of the ARIB, ensure the existence of sufficient information in the Ministry, requiring that copies of reports submitted by the ARIB to the European Commission should also be submitted to the Ministry for information or review, as necessary. Define the roles and responsibility of the Ministry and the ARIB in legislation. **(items 116–117)**	**Response of the Minister of Agriculture:** Copies of the decisions of the ARIB drafted as directives are sent to the Ministry of Agriculture (incl. decisions concerning payments and reclamations of support). The reports submitted to the European Commission are drafted on the basis of these decisions. We will pay great attention to this field in our future work and we will also consider the need to receive copies of various other documents submitted by the ARIB to the Commission.
Harmonisation of reporting 121. Recommendation to the Minister of Agriculture: Harmonise the content and procedure of submission of the report on completed audits to the Ministry. Impose also the obligation to collect information for the report and submit it in its entirety to the ARIB that needs to have information on the problems found during the audits due to its functions as the paying agency. **(items 119–129)**	**Response of the Minister of Agriculture:** The Government of the Republic Regulation No 210 of 16 August 2007 on ‘Specific Procedure for Cooperation between a Paying Agency and Inspection Bodies’ has harmonised the content of the report on completed audits to be submitted to the Ministry and has established a relevant format. We do not consider it necessary to change the procedure of submission.
Improvement of the management and control system 122. Recommendation to the Minister of Agriculture: Establish a management and control system of financial support that would allow assuring the European Commission that support paid for the implementation of the Common Agricultural Policy has been used in accordance with the rules and purposefully. **(items 29–36; 116–117; 119–120)**	**Response of the Minister of Agriculture:** As of the financial year 2007, the head of the paying authority submits together with the annual report also a statement of assurance (1290/2005, Article 8 (1) (c)) confirming that (885/2006, Annex II): The data presented give a true, complete and accurate view of the expenditure and receipts for the financial year mentioned. All debts, advances, guarantees and stocks have been recorded in the accounts, and all receipts collected relating to the EAGF and the EAFRD have been properly credited to the appropriate funds. There is in place a system, which provides reasonable assurance on the legality and regularity of the underlying transactions, including that the eligibility of demands and, for rural development, the procedure for attributing

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	aid, are managed, controlled and documented in conformity with Community rules. **Commentary by the NAO:** In the assessment of the NAO, the mentioned statement of assurance does not entail a confirmation of purposeful use of the funds. Even though the EU legislation has not imposed such obligation on the Member States, Estonia should pay more attention to this and first start to plan and then implement the activities required for the assurance.
Submission of the report 127. Recommendation to the Minister of Agriculture: Establish a requirement that a copy of the violation report should submitted to the managing authority as well. **(items 123–126)**	**Response of the Minister of Agriculture:** Copies of all decisions of the ARIB drafted as directives are sent to the Ministry of Agriculture (incl. decisions concerning payments and reclamations of support). In the future, we will also demand submission of copies of the CAP violation reports to the managing authority.
Reporting to the Government of the Republic 145. Recommendation to the Minister of Finance: Lay down in legislation the mandatory content of reports submitted to the Government of the Republic on the use of the EU support, and the frequency of submission of said reports. **(item 144)**	**Response of the Minister of Finance:** The Ministry of Finance is of the opinion that the Government of the Republic should be kept informed of the current status of the implementation of the EU support, setbacks in the implementation, potential problems that may need responding to, and other important issues that concern the grant and use of the support. We agree with the NAO that, in the future, the overviews presented to the Government of the Republic should at least once a year, after completion of the monitoring reports, also provide a summary overview of the current status of implementation and performance in the basis of the main monitoring indicators, irrespective of the fact that annual monitoring reports are public and available to everyone. If there have been any evaluations or studies that have measured the performance during the year, an overview of the conclusions of such measurements should be presented as well. However, we would like to point out that there were relatively large differences between the Structural Funds, the Cohesion Fund and CAP instruments in the period 2004-2006 and, therefore, it is only logical that the topics discussed under individual instruments have been somewhat variable as well. We agree that it would be useful if the Ministry of Finance and the Ministry of Agriculture would review in the light of this report the content of the overviews presented to the Government of the Republic and would harmonise them as far as possible. At the same time, we are of the opinion that presentation of information should be as flexible as possible, because, on the one hand, the overviews should include information that is current and important at that specific moment in time and, on the other hand, the Government of the Republic has to have the opportunity to request additional information and make running arrangements with regard to the content and scope of the information presented. We also believe that regulation of the processes at the level of legislation of general application cannot be an aim of its own, but should be derived from objective needs, particularly when they deal with the relations between the state's own institutions and agencies, not with third-party relations.
Reporting to the Government of the Republic 146. Recommendation to the Minister of Agriculture: Lay down in legislation the mandatory content of reports submitted to the Government of the Republic on the use of the support envisaged in the Rural Development Plan, and the frequency of submission of said reports. **(item 144)**	**Response of the Minister of Agriculture:** The requirements for the annual monitoring reports and final reports have been established by Article 61 of the Commission Regulation (EC) No 817/2004. Therefore, the monitoring report shall contain overviews of any changes in the general programme conditions, the progress of the programme in relation to the established objectives, the financial performance of the programme, the implementation of the programme (incl. evaluation measures, use of technical assistance, problems encountered and distribution of information), and compatibility with other Community policies. Monitoring reports are available at the web page of the Ministry of Agriculture. In addition, periodic overviews of the implementation of the RDP are presented to the Rural Affairs Committee of the Parliament. We will

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	consider the necessity of establishing the frequency of the presentation of said reports in a legal instrument.
Improvement of management reports 155. Recommendation to the Minister of Finance: Tie management reports to strategic planning in a way that the state's management report would make clear how each ministry has used the EU support and which results have been achieved regarding strategic objectives. **(item 154)**	**Response of the Minister of Finance:** An integrated renewal of the Estonian financial management system in cooperation between the ministries has been launched on the initiative of the Ministry of Finance and, in this year, it will focus on elaboration of the concept of the development or renewal of the financial management. The representatives of the NAO are also involved in this work. The main objective in renewing the financial management system is transition to a performance- and activity-based system using the accrual method, and the content and process of state reporting should be developed correspondingly. An additional objective with regard to reporting is to consolidate the entire state reporting into an integrated system similar to the already operating integrated planning, i.e., combine as far as possible the consolidated reports on the use of state budget funds with the (consolidated) reports on the use of foreign funds. This would be achieved, in particular, in the context of developing the management reports of the state – in order to obtain and transmit a better overview of the effectiveness of the use of financial resources. Therefore, we are already planning to take the steps in the direction recommended by the NAO. The specific format and content of combined reporting and the schedule of implementation will be clarified during the next stages of the process of the development of financial management. We would also like to note, considering the assessment in clause 144, page 29, of the NAO report, that the above described integrated reporting enables both the Parliament and the Government of the Republic to get an annual comprehensive overview of the effectiveness of the use of financial resources derived from both the public revenue and foreign funds. The management report of the state will be discussed, first, by the Government of the Republic and, if approved, it will be then forwarded to the Parliament. We do not see any need for a separate additional consolidated annual report on the use of foreign funds.
Improvement of the efficiency of resource usage 180. Recommendation to the Minister of Agriculture: Consider combining the ex-post checks with the audit of expense receipts in order to use the resources efficiently and reduce interference with the activities of the final recipients. **(items 177–179)**	**Response of the Minister of Agriculture:** We would like to point out that, in the case of investment support, the support is paid to the beneficiary after submission of expense receipts. As a rule, a project should be implemented within two years, which means that the expense receipts are also submitted during this period. Pursuant to Council Regulation (EC) 1260/1999, a Member State shall secure the contribution of the EU Structural Funds for five years of the date of the decision on the support, which means that the object has to be used for the intended purpose for five years. Considering the fact that payments are generally made significantly earlier than the five-year period, the ex-post checks and audit of expense receipts cannot be combined. The number of inspections conducted by ARIB is in conformity with the Commission Regulation No 1975/2006 that specifies the minimum control rates for the current programming period. Pursuant to this Regulation, at least one on-site inspection is required for each project of the investment instruments in order to verify actual realisation of the investment, ex-post checks are required after payment of support to cover at least 1 % of eligible expenditure, and, additionally, on-site inspection of the expense receipts is required to cover 5 % of eligible expenditures paid.
Improvement of the register of structural assistance 184. Recommendation to the Minister of Finance: Ensure that the register of structural assistance would include records on the elimination of the deficiencies discovered during supervision and develop the database accordingly if necessary. **(items 181–183)**	**Response of the Minister of Finance:** The Ministry of Finance shares the opinion of the NAO that the functionalities provided by the register of structural should be used to their full potential. We would like to point out that the register is being continuously developed as a result of the need to improve the efficiency of data transmission, processing and analysis. Therefore, the number of usage features of the register of structural assistance has increased considerably over time. An important factor considered in the development is increasing the user-friendliness of the register so that the operations in the register would be as simple and timesaving as possible.

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	The register of structural assistance is a project management system and, therefore, all data in the register have been recorded by individual projects. The data entered for individual projects can be consolidated and expressed in the form of statistical reports. Information on the supervision operations and deficiencies discovered have been entered in the register since the first stages of implementation and, therefore, the basic information on the on-site inspections of individual projects is already available. However, register upgrades are being currently developed (August 2007) in order to enable classification of discovered deficiencies (and using this information for the purposes of analysis and risk assessment) and registration of the compliance with issued precepts. The development also concerns several reports associated with on-site inspections, which, among other things, will enable the user easy access to consolidated information on the number of on-site inspections, the amount of funds covered with on-site inspections, etc. Consequently, the Ministry of Finance agrees with the recommendation of the NAO and has taken account of it.
Improvement of administrative capacity 194. Recommendation to the Minister of Finance: Pay more attention to increasing the administrative capacity, using the experiences gained in the first financing period and preventing the recurrence of the same problems in the new period. **(item 193)**	**Response of the Minister of Finance:** Undoubtedly, the administrative capacity required for the grant and use of the EU support must be ensured. Many problems mentioned in the Special Report have been discovered in the course of monitoring, which means that both the Ministry of Finance and the Monitoring Committee have been aware of these problems and have responded to them. Among other activities, the Ministry of Finance, intermediate bodies and final beneficiaries have paid constant attention to communication, disclosure, publicity and information in order to improve the knowledge of the public, applicants and final recipients of the structural instruments and the rules related to the use of these instruments. Regular training courses are organised in the field of public procurements and the managing authority prepares guidance materials – the same is done in several other areas as well. Most of the bottlenecks associated with the compatibility of the register of structural assistance with the information systems of the Enterprise Estonia and ARIB have been eliminated and the register of structural assistance now includes the data on the projects of all final beneficiaries. In a situation where the grant and use of the support is essentially based on projects, the changes in conditions in the case of some projects always lead to delays and implementation problems. What is important is that there is an administrative structure able to discover to these problems (monitoring, audit, evaluation, etc., in the course of the process) and respond in an appropriate manner to solve them. The Ministry of Finance monitors the implementation on a daily basis and strives towards a situation where the problems could be discovered and eliminated as efficiently as possible. We certainly agree that the experiences gained during the period 2004-2006 must be taken into account when preparing for the period 2007-2013 and this has been already done in a number of issues.
Evaluating the effectiveness of support 221. Recommendation to the Minister of Agriculture: Organize the assessment of the cost-effectiveness of the use of support of Rural Development Plan as well as an assessment of the attainment of objectives. **(item 220)**	**Response of the Minister of Agriculture:** We would like to point out that evaluation of the objectives of CAP can take place only on the background of the objectives arising from Article 33 of the EC Treaty (see also the response to item 5). The general procedures for monitoring and evaluation in the case of rural development support under CAP have been provided in Chapter V of Title III of the Council Regulation (EC) No 1257/1999 and Title IV of the Council Regulation (EC) No 1260/1999. Continuous evaluation of the environmental support in the case of the RDP 2004-2006 is performed by the Agricultural Research Centre. In addition, an ex-post evaluation should be conducted after the end of the programme, starting in the second half of 2007. Normal interim evaluation of the programme was omitted due to the short duration of the programme. **Commentary by the NAO:** With its recommendation, the NAO would like to point out that the minimum requirements established by the EU legislation may not be sufficient for receiving operative information within the country on

Recommendations of the NAO	Replies from the Minister of Finance and Minister of Agriculture
	the effectiveness and purposefulness of the use of the support. The NAO is of the opinion that it is possible and legally correct to evaluate the effectiveness and purposefulness of the use of support, irrespective of whether this has been provisioned in the EU legislation. Naturally, this should be done in compliance with the established requirements and without failing to perform the obligation of ex-post evaluation.
Establishing the causes of occurred errors 229. Recommendation to the Minister of Agriculture: Find out why so many errors are made in the use of supports and take measures for reducing the number of said errors. **(items 224–228)**	**Response of the Minister of Agriculture:** An information booklet "Assistance for Applicant" is drawn up for each support, whose purpose is to help the applicant in preparing the application for the support. In addition to this, the Ministry of Agriculture and ARIB organise information days both for agricultural advisers and applicants for support prior to the application round of each measure. Arising from this, the Ministry of Agriculture is of the opinion that notification of applicants is thorough and diverse possibilities have been created for dissemination of information. For the better notification of applicants, the Ministry of Agriculture and ARIB have launched a cooperation project for the development of counselling and notification activities. The compiler of the report fails to pay attention to Table 12 and item 250, pursuant to which approximately half of the infringements occurring in the use of supports in the EU as a whole have been identified mainly in the course of EAGGF funds, which can be explained by the specifics of the agricultural sector and agricultural refunds, where there are a large number of applicants. The number of types of supports paid from EAGGF is also very large, ranging from direct aids to investment aids. For example, there are approximately 19,000 applicants for single area aid in Estonia. **Comment of the NAO:** The NAO is pleased that the Minister of Agriculture has understood the relevance of the emerged problem, has analysed the causes for this situation and has started to take measures.

Description of the special report

Purpose of the special report

The National Audit Office prepared a special report in order to get an overview of the use of support allocated to Estonia by the European Union. Here, the purpose was to find out whether Estonia has managed the use of support funds well in Estonia's first financing period after accession. Upon analysing materials and drawing up the report, the NAO wished to find out whether Estonia is ready to officially state to the European Commission that the management and control systems implemented in Estonia are in function and that the EU support funds have been used in compliance with established rules.

Scope and approach of the special report

The NAO did not have an overview of all sums paid to Estonia by the European Union, as many support funds are paid directly to applicants pursuant to rules, and this recipient may not be a state authority and these sums are not centrally recorded in Estonia. To find out the amount of support paid to the budget of the state of Estonia by the EU in 2004–2006, the NAO asked for relevant data from the European Commission. Unfortunately, the Commission has not yet been able to present the necessary information on payments to the NAO. Thus, in financial terms, the report addresses the three biggest supports paid to the state of Estonia, whose use is planned by the state's strategies: support from Structural Funds and Cohesion Fund and support for the implementation of the EU common agricultural policy.

Upon drawing up the report, the NAO focused on using the support on management and control systems, reporting and planning the support in the budget as well as its actual use in the period of 2004–2006. In addition, the NAO examined the management and control system in relation to Estonia's contribution into the EU budget.

The basis for the report mostly included materials available to the public (e.g. legislation, overview of foreign aid, monitoring reports, assessment reports, reports of the European Court of Auditors, auditing yearbooks of the EU Structural Funds), but relevant authorities were questioned about their internal procedures and officials engaged in the respective field were also interviewed. The opinions listed in the report are based on materials that are available to the public and materials that were made available to the NAO as well as on the explanations of officials. The NAO specifically chose to not carry out system audits or other audits for the special report, but relied on the work performed by ministries and their sub-offices, monitoring committees and external assessors. Some reports of audits performed by the NAO in this field are provided in Chapter 6 of the report.

Explanations and necessary information was provided to the NAO by the Ministry of Finance, Ministry of Agriculture, Ministry of Economic Affairs and Communications, Majandus- ja Kommunikatsiooniministeerium the Environment and Agricultural Registers and Information Board.

Time of completion of the special report:

The special report was completed in July 2007.

Compilation team for the special report:

The special report was compiled by the following auditors: Gerli Eisberg, Kristi Kährin, Karin Rajapu ja auditijuht Krista Zibo.

Contact

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An electronic copy (pdf) of the special report is available at the website of the NAO: www.riigikontroll.ee.

The summary of the special report is also available in English.

The number of the special report in the NAO's record management system is OSI-2-1.4/07/86.

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Annex 1. Intermediate bodies and final beneficiaries in 2004–2006

PRIORITY	INTERMEDIATE BODY	FINAL BENEFICIARY
Priority 1: DEVELOPMENT OF HUMAN RESOURCE		
1.1. Educational system that shall ensure flexibility of workforce, coping and lifelong learning and shall be available to all (ESF)	Ministry of Education and Research	SA INNOVE
1.2. Development of human resource for the improvement of businesses' economic competitiveness (ESF)	Ministry of Economic Affairs and Communications	Enterprise Estonia
1.3. Equal opportunities on labour market (ESF)	Ministry of Social Affairs	Labour Market Board
1.4. Improvement of administrative capacity (ESF)	State Chancellery	State Chancellery
Priority 2: COMPETITIVENESS OF BUSINESS		
2.1. Supporting businesses' development (ERDF)	Ministry of Economic Affairs and Communications	Enterprise Estonia
2.2. Supporting development of business infrastructure (ERDF)		
2.3. Promotion of research and development and innovation (ERDF)		
2.4. Development of tourism (ERDF)		
Priority 3: AGRICULTURE, FISHERY AND RURAL RURAL DEVELOPMENT		
3.1. Investments in farming system (EAGGF)	Ministry of Agriculture	Agricultural Registers and Information Board
3.2. Investment aid for the processing of agricultural produce and improvement of marketing (EAGGF)		
3.3. Diversification of economic acitivities in rural areas (EAGGF)		
3.4. Integrated land improvement (EAGGF)		
3.5. Restoration and development of villages (EAGGF)		
3.6. Development of local initiative – LEADER (EAGGF)		
3.7. Forest management (EAGGF)		
3.8. Supporting counselling service and dissemination of information (EAGGF)		
3.9. Regulating the fishing capacity of fishing fleet (FIFG)		
3.10. Modernisation and renewal of fishing fleet (FIFG)		
3.11. Investment support measures of fisheries' course of handling (FIFG)		
3.12. Other measures related to fishery (FIFG)		
Priority 4: INFRASTRUCTURE AND LOCAL DEVELOPMENT		
4.1. Development of infrastructure of transport (ERDF)	Ministry of Economic Affairs and Communications	Road Administration
		Estonian Railway Inspectorate
		Tallinn Airport Ltd.
		Maritime Administration

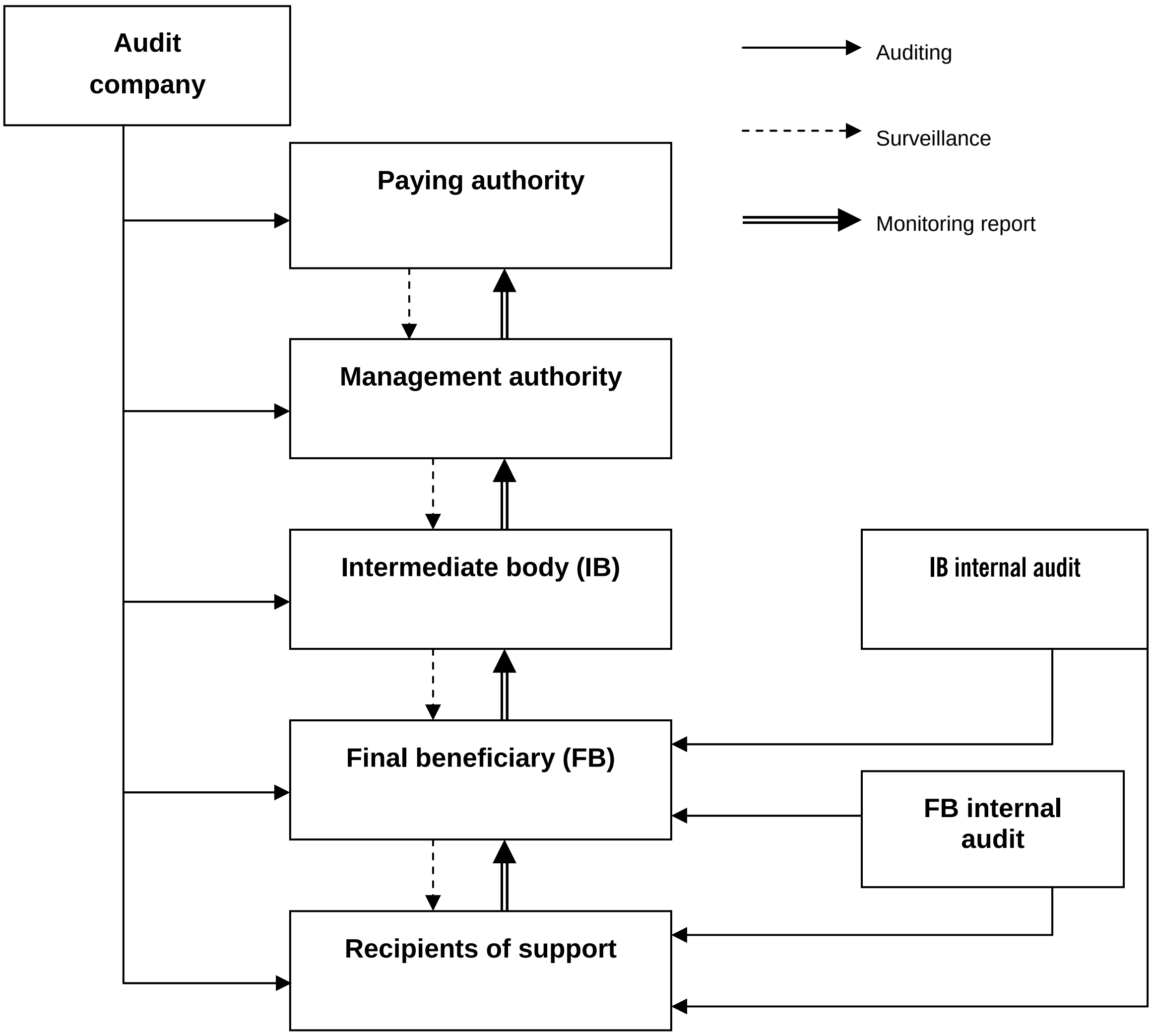
4.2. Development of environmental infrastructure (ERDF)	Ministry of the Environment	Environmental Investment Centre
4.3. Modernisation of vocational education and higher education as well as of the accompanying infrastructure (ERDF)	Ministry of Education and Research	SA INNOVE
4.4. Reorganization of hospital network (ERDF)	Ministry of Social Affairs	Ministry of Social Affairs
4.5. Development of information society (ERDF)	Ministry of Economic Affairs and Communications	Estonian Informatics Centre
4.6. Local socio-economic development (ERDF)	Ministry of the Interior	Enterprise Estonia
Priority 5: TECHNICAL ASSISTANCE		
5.1. Programme management and implementation (ERDF)	Ministry of Finance	Ministry of Finance

Annex 2. Intermediate bodies and final beneficiaries in 2007–2013

	Operational programme for the development of business environment	Intermediate bodies	Final beneficiaries
1	Business's ability to renew and grow	Ministry of Economic Affairs and Communications	Enterprise Estonia, Credit and Export Guarantee Fund KredEx
		Ministry of the Environment	Enterprise Estonia
2	Strengthening the competitiveness of Estonian research and development through research programmes and modernization of institutions of higher education and research institutions	Ministry of Education and Research	SA Archimedes
3	Transport investments of strategic relevance (CF)	Ministry of Economic Affairs and Communications	Maritime Administration Estonian Railway Inspectorate Road Administration Tallinn Airport Ltd.
4	Development of infrastructure of transport of regional importance	Ministry of Economic Affairs and Communications	Maritime Administration Estonian Railway Inspectorate Road Administration Tallinn Airport Ltd.
5	Improvement of information society	Ministry of Economic Affairs and Communications	Estonian Informatics Centre
6	Horisontal technical assistance	Ministry of Finance	Ministry of Finance
7	Technical assistance	Ministry of Finance	Ministry of Finance
	Operational programme for the development of human environment	**Intermediate bodies**	**Final beneficiaries**
1	Development of water economy and waste handling	Ministry of the Environment	Environmental Investment Centre
2	Development of infrastructure and support systems for sustainable use of the environment	Ministry of the Environment Ministry of Social Affairs	Environmental Investment Centre
3	Development of the energy sector	Ministry of Economic Affairs and Communications Ministry of the Environment	Environmental Investment Centre Credit and Export Guarantee Fund KredEx
4	Wholesome and balanced development of regions	Ministry of the Interior	Enterprise Estonia
5	Development of infrastructure of education	Ministry of Education and Research	SA INNOVE
6	Development of infrastructure of health and social welfare	Ministry of Social Affairs	Ministry of Social Affairs

7	Horisontal technical assistance	Ministry of Finance	Ministry of Finance
8	Technical assistance	Ministry of Finance	Ministry of Finance
	Operational programme for the development of human resources	**Intermediate bodies**	**Final beneficiaries**
1	Lifelong learning	Ministry of Education and Research Ministry of the Environment	SA INNOVE Enterprise Estonia
2	Development of human resource in research and development activities	Ministry of Education and Research	SA Archimedes
3	Work life of length and quality	Ministry of Social Affairs	SA INNOVE
4	Knowledge and skills for innovative business	Ministry of Economic Affairs and Communications	Enterprise Estonia, Credit and Export Guarantee Fund KredEx
5	Better administrative capacity	State Chancellery, Ministry of the Interior	State Chancellery, Enterprise Estonia
6	Horisontal technical assistance	Ministry of Finance	Ministry of Finance
7	Technical assistance	Ministry of Finance	Ministry of Finance

Annex 3. Inspection of the use of Structural Funds



Annex 4. Main findings of audits on the use of Structural Funds by priorities and observations

Audit observation	Priority 1	Priority 2	Priority 3	Priority 4	Priority 5
Shortcomings in the legislation regulating the administration of support schemes	2	4	9	4	0
Legal relations between authorities are incorrectly regulated	3	4	1	2	0
The rules of procedure did not comply with the requirements established in the legislation and were not in compliance with the NDP (and unapproved)	4	4	12	5	1
Employees of intermediate bodies and final beneficiaries have not complied with the rules of procedure	3	0	1	3	0
Insufficient (incl. unapproved) statues, job descriptions	4	4	5	5	1
The principle of separation of obligations has not been ensured or complied with (e.g. in replacing employees)	4	4	0	5	1
Shortcomings in the organization of surveillance (incl. on-the-spot checks, monitoring)	2	1	2	3	0
Shortcomings in the applications' processing / assessment / decision-making phase (decisions regarding the declaration of suitability are not reasoned enough, delays in proceeding, etc.)	3	1	4	3	0
Insufficient audit trail (failure to manage documents, absence of measures for the preservation of information)	3	2	3	5	0
Insufficient documentation for the intermediate body and the final recipient (insufficiently recorded documents, reports, agreements or absence of documents)	4	3	0	1	0
Insufficient data in information system	2	1	0	0	0
Shortcomings in the organization of accounting of the final recipient (incl. the absence of internal rules)	3	4	2	5	0
Disclosure requirement for compromised information	3	1	2	0	1
Shortcomings in the organization and documentation of public procurements (failure to obtain three tenders)	3	1	1	1	0
Non-eligible expenses	4	1	0	1	1
TOTAL	**47**	**35**	**42**	**43**	**5**

Annex 5. Main findings of audits on the use of the Cohesion Fund by sectors and observations

Audit observations	Environmental sector	Transport sector	Total
Non-eligible expenses	5	3	8
Insufficient organization of accounting	4	4	8
Shortcomings in the monitoring of expenses (the monitoring of relevant invoices had not been agreed upon between the internal audit and final beneficiary)	1	3	4
Legal relations between authorities are incorrectly regulated	0	1	1
The rules of procedure did not comply with the requirements established in the legislation	4	11	15
Employees of intermediate bodies and final beneficiaries have not complied with the rules of procedure	3	3	6
Statues and job descriptions do not comprise all tasks, rights and obligations of implementing the Cohesion Fund	1	1	2
Disclosure requirement for compromised information	1	4	5
Insufficient documentation (incl. archival processing)	1	1	2
Problems with procurement	3	1	4
TOTAL	**23**	**32**	**55**