

AUDIT REPORT

Riga

19 November 2009

No.5.1-2-18/2009

Activity of the Ministry of Agriculture and Institutions Subordinated Thereto in Relation to Supervision of the Handling of Food and Administration of Food Products Export to the Russian Federation

Legal Justification of the Audit

1. Legality audit regarding the activity of the Ministry of Agriculture and institutions subordinated thereto in relation to supervision of the handling of food and administration of food products export to the Russian Federation (hereinafter – the audit) was conducted according to the Audit Plan of the State Audit Office for 2009 and the audit assignment of the Fourth Audit Department of 11 May 2009
2. The audit was conducted in cooperation with the Accounts Chamber of the Russian Federation:
 - 2.1. On the basis of the Memorandum for Mutual Cooperation between the Accounts Chamber of the Russian Federation and the State Audit Office of the Republic of Latvia;
 - 2.2. In accordance with the requirements of regulatory enactments of each country and recognised auditing standards;
 - 2.3. The Accounts Chamber of the Russian Federation auditing responsible institutions of the Russian Federation and the State Audit Office of the Republic of Latvia auditing the Ministry of Agriculture and institutions subordinated thereto;
 - 2.4. Auditing issues related to both countries, as well as including issues in the scope of the audit that are essential within respective country for achievement of the audit objective.
3. Findings of the parallel audit conducted by the Accounts Chamber of the Russian Federation and the State Audit Office of the Republic of Latvia will be presented in the informative report drawn up by both countries. This report includes only the audit findings of the State Audit Office of the Republic Latvia.
4. The audit was conducted by State Auditor-Lawyer Dace Teiviša, Senior State Auditor Liene Upeniece, State Auditors Inese Meijere and Baiba Meņģele.

Audit Objective

5. The objective of the audit is to obtain assurance whether:
 - 5.1. The activity of the Ministry of Agriculture and institutions subordinated thereto, regulating export of Latvian food products to the Russian Federation, complies with the requirements of the regulatory enactments and is organised in such way:

- 5.1.1. To facilitate observance of the State economic interests, increasing export volumes to the Russian Federation;
- 5.1.2. To ensure efficient State supervision of the handling of food;
- 5.2. The activity of the Ministry of Agriculture in the area of export promotion ensures achievement of objectives specified in the export promotion policy documents and efficient utilisation of the State budget funds.

Accountability of the State Audit Office Auditors

- 6. Auditors of the State Audit Office are responsible for the audit report, which is based on the audit evidence obtained during the audit.

Accountability of the Ministry of Agriculture and Institutions Subordinated Thereto

- 7. The Ministry of Agriculture, Food and Veterinary Service, Rural Support Service and the State scientific institute – derived public person Latvian State Institute of Agrarian Economics are responsible for observance of the regulatory enactments and truthfulness of the information provided to the auditors.

Scope of the Audit

- 8. The audit is conducted in accordance with international auditing standards recognised in the Republic of Latvia. The audit was planned and performed to obtain reasonable assurance on compliance with the requirements of regulatory enactments of activity of the following institutions and efficient utilisation of the State budget funds:
 - 8.1. Organisational structure and activity of the Ministry of Agriculture, developing and implementing the State and the European Union aid policy in the field of agriculture and fishery;
 - 8.2. Activity of Rural Support Service, administering export compensations;
 - 8.3. Activity of Latvian State Institute of Agrarian Economics related to market and export promotion;
 - 8.4. Activity of Food and Veterinary Service:
 - 8.4.1. Administering food products export to the Russian Federation;
 - 8.4.2. In the area of State supervision and control on the handling of food.
- 9. The audit was conducted on the period from 1 January 2008 to 30 June 2009.
- 10. Examination, assessment and documents analysis was performed for obtaining audit evidence, as well as the interviews of management and responsible officials of the Ministry of Agriculture, Food and Veterinary Service, Rural Support Service and Latvian State Institute of Agrarian Economics were conducted.
- 11. The audit provided sufficient and according audit evidence for drawing up the audit report.

Summary

Administering and Promotion of Latvian Food Products Market and Export

- 12. Institutional system for promotion of food products export in Latvia is fragmented, as it involves the Ministry of Agriculture, other sector ministries, institutions subordinated thereto, as well as sector organisations, which administer various national and the European Union aid mechanisms without sufficient mutual coordination.

13. Although at large the objective specified in the policy planning document on export promotion¹ is achieved, national aid measures on export promotion implemented by the Ministry of Agriculture are not being planned in such way, so that implementation thereof would ensure achievement of objectives specified in the policy planning document in reasonably efficient way and expedient utilisation of the State budget funds, as:
- 13.1. The policy planning documents on export promotion do not define purposeful and sequential measures, as well as do not indicate planned financing for implementation of measures, thus the approach of the Ministry of Agriculture to development of policy planning documents is purely formal;
 - 13.2. Information on available national and the European Union aid mechanisms on export promotion of food products and on responsible institutions of the Ministry of Agriculture and other State administration institutions responsible for administering thereof is not provided to interested parties in easily accessible and reasonably understandable way ;
 - 13.3. National aid available to food products exporters from the State budget financing allocated to the Ministry of Agriculture is implemented within the framework of annual Programme on Promotion of Agricultural and Food Products Market. Of the total State budget financing approved for the programme in 2008 in the amount of LVL 1 500 000 only 34% were planned for implementation of export promotion measures, in 2009 – 37% of the total financing in the amount of LVL 900 000 approved for the programme, in turn according to the amendments to the programme for 2009 submitted by the Ministry of Agriculture – 50% of the total financing in the amount of LVL 700 000 approved for the programme;
 - 13.4. It is not possible to establish the level of objective achievement of the Programme on Promotion of Agricultural and Food Products Market, as well as to obtain assurance on the necessity of the State budget funds provided for achievement of objectives, taking into consideration that:
 - 13.4.1. The objectives of the programme and programme measures are process driven, and performance indicators for achievement of objectives are not specified;
 - 13.4.2. Programme management and organisational expenditure in 2008 were approved in the amount of 31% of total programme expenditure, also providing resources for raising of qualification of personnel involved in programme administration and for bonuses in the amount of LVL 28 810, in 2009 – 28% of total programme expenditure, not providing resources for raising of qualification and bonuses;
 - 13.4.3. Not all export promotion measures of the programme and the resources necessary for implementation thereof are determined in the reasoned amount and are directly related to achievement of measure objectives, for example, expenditure in the amount of LVL 27 730 and LVL 30 002 was disbursed to the service provider for catering of 150 persons at the international exhibition organised in 2008 and 2009, which was the most expensive one in terms of costs;

¹ Export Promotion Programme of Latvia for 2005, approved by the Cabinet Order No.755 of 14 October 2004.

- 13.5. State budget financing in the amount of LVL 900 000 was transferred as 100% advance payment to the implementer of the programme – Latvian State Institute of Agrarian Economics, before the programme for 2009 was harmonised with the Ministry of Agriculture.
14. The aid allocation scheme developed for implementation of the Programme on Promotion of Agricultural and Food Products Market, providing for involvement of four institutions – the Ministry of Agriculture, the Rural Support Service, Latvian State Institute of Agrarian Economics and the association “Marketing Council”, does not comply with regulatory enactments and is not transparent, as:
- 14.1. Financing for implementation of the programme is allocated to a public derived person Latvian State Institute of Agrarian Economics, although respective authorisation is not provided by any law;
- 14.2. The association “Marketing Council” takes decisions on allocation of aid to companies without authorisation specified in regulatory enactments, thus a situation is created that decisions on allocation of the State budget funds are taken by persons, who are not State officials;
- 14.3. Aid within the framework of the programme is allocated to applicants according to the procedures approved by the association “Marketing Council”, which is not harmonised with the Ministry of Agriculture as the institution supervising aid administration.
15. Members of the association “Marketing Council” have approved a regulation², according to which aid for export promotion measures shall be allocated within the framework of the Programme on Promotion of Agricultural and Food Products Market. However the requirements of the regulation are regularly violated, which indicates purely formal approach to administering export promotion measures under the programme and does not create assurance on justified utilisation of the State budget funds:
- 15.1. Contrary to the requirements of the regulation³ several companies have received aid in the total amount of LVL 13 806, although on the date of aid receipt the companies had tax debts to the State budget in the total amount of LVL 151 231. Moreover the aid was allocated on the basis of statements from the State Revenue Service regarding payment of taxes and statements from the Enterprise Register on the insolvency status, which were submitted up to seven months prior to the company’s participation in the export promotion measure, thus they are not representing current information and do not provide view on the actual status of tax debts and insolvency on the date of receipt of the State aid;
- 15.2. The requirement of the regulation of the Marketing Council⁴ that companies within 30 days from taking part in an export promotion measure shall submit a report on the results of the measure, has imposed unreasoned additional administrative burden on aid recipients, as the information provided in a

² Regulation regarding participation in international exhibitions and marketing measures in export markets within the framework of the Programme on Promotion of Agricultural and Food Products Market, approved on 24 April 2007 at the general meeting of members of the association “Marketing Council” (hereinafter – Regulation of the Marketing Council of 24 April 2007).

³ Sub-paragraph 42.3 of the Regulation of the Marketing Council of 24 April 2007.

⁴ Sub-paragraph 29.2 of the Regulation of the Marketing Council of 24 April 2007.

company's report is not being analysed to assess efficiency of the measures and to plan measures and financing for the coming year;

- 15.3. The audit disclosed occasions, when the aid was allocated not requesting source documents. The aid was also allocated, on the basis of source documents submitted by aid recipients, which do not always provide reasonable assurance on participation of a company in the supported event and on related expenditure.
16. Majority of the companies that have received aid within the framework of the measure of the Programme on Promotion of Agricultural and Food Products Market "Co-financing of Marketing Measures in Export Markets" are members of the association "Marketing Council". Besides the financing allocated for the measure in 2008 was utilised only in the amount of 66%, which possibly indicates that:
 - 16.1. Potential applicants were not provided with sufficient information on the possibility of receiving aid within the framework of the measure or
 - 16.2. Support intensity specified for the measure – 25% or 35% of eligible expenditure, with respect to requirements put forward to receiving the aid, does not motivate potential applicants to apply for the aid.

System for Control and Supervision of the Handling of Food, Including Company Recognition for Export to the Russian Federation

17. Latvia as the Member State of the European Union has the right to enter into bilateral cooperation agreements with the Russian Federation only in the areas, where the European Commission has harmonised cooperation agreement model with the Russian Federation. Respectively on 14 January 2009 the Memorandum has been signed with the Russian Federation regarding export of fishing products and produce to the Russian Federation, which is the only contractual framework in force between the responsible institutions of both countries for cooperation and information exchange in the field of export of food of animal origin.
18. In the audited period cooperation of the Veterinary and Phytosanitary Supervision Service of the Russian Federation and the Food and Veterinary Service was not optimal, taking into consideration that:
 - 18.1. In the audited period regular information exchange took place between the Food and Veterinary Service and the Veterinary and Phytosanitary Supervision Service of the Russian Federation, within the framework of which, upon several indications of the Food and Veterinary Service regarding the necessary changes, the information received from the Veterinary and Phytosanitary Supervision Service of the Russian Federation regarding Latvian companies recognised for export to the Russian Federation is still not accurate;
 - 18.2. As the provisions of the Memorandum regarding export of fishing products and produce to the Russian Federation cannot be unambiguously interpreted, the Food and Veterinary Service does not issue final approval to companies for export to the Russian Federation, before written approval of the Veterinary and Phytosanitary Supervision Service of the Russian Federation is received, therefore Latvian companies are denied the possibility of commencing export transactions to the Russian Federation, thus Latvian fishing products processing companies may lose potential cooperation partners in the Russian Federation.

19. As the Food and Veterinary Service has not developed unified criteria for recommending slaughterhouses, milk and meat processing companies and for recognition of fishing products processing companies for export to the Russian Federation, and regulatory enactments of the Food and Veterinary Service do not specify what kind of disclosed incompliance may become the reason for not recommending or recognising for export to the Russian Federation of a company, there is a risk that:
 - 19.1. Decisions of the Food and Veterinary Service on recommending or recognising for export to the Russian Federation of companies may be not consistent and equal with respect to all companies;
 - 19.2. The Food and Veterinary Service, by determining the companies as compliant with the requirements of the Russian Federation, which in fact do not comply with the requirements, will not provide the grounds to responsible institutions of the Russian Federation for trusting the inspections carried out by the Service, thus cooperation between institutions of both countries in relation to recognition of companies engaged in the handling of food may become more complex.
20. Although quality activities with regard to supervision and control of the handling of food would help to promote export ability of Latvian companies involved in the handling of food, the food handling State supervision system developed by the Food and Veterinary Service for control of companies engaged in handling of animal origin food and trade companies does not ensure sufficient State supervision, as:
 - 20.1. The Food and Veterinary Service has decreased minimum established inspection frequency for 2009 in relation to companies engaged in the handling of food. Inspection frequency decrease that was made on the basis of decrease in the allocated State budget financing was not sufficiently assessed, thus there is a possibility that several types of business activities are not sufficiently supervised;
 - 20.2. Activity of the Food and Veterinary Service on implementation of specific priority measures related to product inspections at sales locations does not provide the assurance on efficiency of implementation of priority measures and equal approach, controlling food products imported to Latvia from the European Union Member States, from third countries and produced in Latvia, in order to facilitate fair competition of imported and locally produced food products;
 - 20.3. In 2008 40% of companies engaged in producing food products of animal origin and trading companies were not supervised in accordance to planned minimum inspection frequency, besides the Food and Veterinary Service has not sufficiently coordinated the activity of territorial units so that inspections would be planned and carried out according to unified principles;
 - 20.4. Company assessment and fine infliction system developed by the Food and Veterinary Service does not provide for sufficient motivation for companies to operate in accordance with the requirements of regulatory enactments, the fact is also certified by the high percentage of companies – 55% - where deficiencies were disclosed regularly in 2008. The territorial units do not observe the principle of equality with regard to assessment of companies engaged in the handling of food and fine infliction.
21. Territorial units of the Food and Veterinary Service, where the highest number of

complaints was received regarding the quality of food products, have not always ensured prompt inspection of complaints, thus the Food and Veterinary Service has not prevented the situation, when poor quality and unhealthy food reaches customers, moreover, during extended period of time has not ensured control over compliance of specific meat products with the regulatory enactments and equal approach to market players.

22. In accordance with the regulatory enactment of the European Union⁵ supervision of meat handling companies⁶ shall be performed by the State authorised veterinarians of the Food and Veterinary Service, and actual expenditure related to supervision shall be covered by meat handling companies. It was disclosed in the audit that organisation of activity of the State authorised veterinarians does not comply with the requirements of regulatory enactments and does not indicate efficient supervision and expedient utilisation of resources, as:
 - 22.1. The Food and Veterinary Service includes administrative expenditure in the amount of 10% into actual supervision expenditure, not providing any reasoned calculations;
 - 22.2. In 2008 and first half of 2009 the Food and Veterinary Service obtained revenue in the amount of LVL 111 454 for administrative expenditure, which was not calculated according to actual administrative expenditure of the Food and Veterinary Service, thus companies were inflicted additional unreasoned expenditure;
 - 22.3. Inspections carried out by the State authorised veterinarians and food inspectors on several supervision stages provide for verification of compliance with the same requirements of regulatory enactments, financing the inspections both from the State budget and from company resources, however the majority of food handling companies – 89% in 2008 and 92% in 2009 – are regularly evaluated as partly compliant or incompliant with the requirements of regulatory enactments.
23. The number of staff members and the structure developed for supervision of companies engaged in the handling of food at the central administration of the Food and Veterinary Service and the territorial units is not sufficiently assessed, as:
 - 23.1. In the period from 1 January 2008 to 30 June 2009 the number of positions at the central administration of the Food and Veterinary Service was decreased by 20 positions or 14.3%, but at the territorial units – by 200 positions or by 33.2%, which is 10 times larger decrease of positions than at the central administration of the Food and Veterinary Service;
 - 23.2. 91.8% of total number of employed by Food Supervision Department and Veterinary Supervision Department of the Food and Veterinary Service are management level employees;
 - 23.3. Ratio of verifiable companies involved in the handling of food and the number of inspectors of the Food and Veterinary Service significantly differs in various territorial units – average number of companies per one inspector in the first half of 2009 ranged from 96 to 221 companies.

⁵ Article 1, Chapter I of the Regulation (EC) No.882/2004 of the European Parliament and the Council of 29 April 2004 on official controls performed to ensure the verification of compliance with feed and food law, animal health and animal welfare rules.

⁶ Until first half of 2009 162 slaughterhouses, meat and wild game meat processing companies.