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DRAFT AUDIT REPORT

Audit No. REGC414CZ0133

ENQUIRY:

Enquiry Planning Memorandum Thematic Audit on the compliance of the management and control systems with the regulatory framework related to the measures to avoid conflict of interests

2007 – 2013, 2014 – 2020

FUNDS:

ERDF, CF and ESF

MEMBER STATE:

Czech Republic

OPERATIONAL PROGRAMME:

2007CZ161PO004 Enterprise and Innovation OP

2007CZ161PO006 Environment OP

2014CZ16RFOP001 Enterprise and Innovation for Competitiveness OP

2014CZ16M10P002 Environment OP

2007CZ05UPO001 Human Resources and Employment

2007CZ052PO001 Prague – Adaptability OP

2014CZ05M9OP001 Employment OP

SCOPE/ KEY REQUIREMENTS AUDITED:

Compliance of the management and control systems with the regulatory framework related to the measures to avoid conflict of interests

KR 2: Appropriate selection of operations

KR 4: Adequate management verifications

KR 16: Adequate audits of operations

AUTHORITIES AUDITED:

Bodies involved in the process of managing and allocating EU funds

Horizontal bodies:

- ESIF Council (*Rada pro ESI fondy*)

- Council for the Common Strategic Framework (*Rada pro fondy Společného strategického rámce*)
- National Coordination Authority (*Národní organ pro koordinaci*)
- Management and Coordination Committee (*Řídící a kontrolní výbor*)

Managing authorities and intermediate bodies:

- Ministry of Labour and Social Affairs
- City of Prague
- Ministry of Industry and Trade
- Business and Investment Development Agency - CzechInvest (*Agentura pro podporu podnikání a investic CzechInvest*)
- Agency for Business and Innovations (*Agentura pro podnikání a inovace*)
- Ministry of Environment
- The State Environmental Fund of the Czech Republic (*Státní fond životního prostředí České republiky*)

ADDRESSEES OF THE REPORT: His Excellency Mr Jakub DÜRR
Ambassador Extraordinary and Plenipotentiary
Permanent Representative of the Czech Republic
Rue Caroly 15/Carolystraat 15,
1050 Bruxelles/Brussel, BELGIUM

DATE OF AUDIT: 8 January to 15 February 2019

DG/UNIT CHEF DE FILE: REGIO and EMPL

ASSOCIATED DGs: AGRI

EXTERNAL FIRM: none

This report sets out the provisional findings, conclusions and recommendations of the Commission auditors. These may be modified in the light of the observations and further information received from the national authorities. Accordingly, this report should be treated as confidential until the follow-up procedure has been brought to a final conclusion. If the whole or part of the report is transmitted to persons concerned by the audit to enable them to provide comments, please ensure that the information set out in this paragraph accompanies the transmission.

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List of acronyms

AA	Audit authority
AC	Assessment criterion
CCI	Common Code for Identification
CF	Cohesion Fund
CPR	Common Provisions Regulation (Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17.12.2013)
CPV	Common public procurement vocabulary
ENV OP	Environment Operational Programme
ERDF	European Regional and Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
IB	Intermediate Body
IB-SFZP	Intermediate Body - State Environmental Fund of the Czech Republic (<i>Státní fond životního prostředí České republiky</i>)
IB -CZIn	Intermediate Body – Business and Investment Development Agency - CzechInvest (<i>Agentura pro podporu podnikání a investic CzechInvest</i>)
IB API	Intermediate Body - Agency for Business and Innovations (<i>Agentura pro podnikání a inovace</i>)
INTOSAI	International Organisation of Supreme Audit Institutions
KR	Key Requirement
MA	Managing authority
MA EIC	Managing authority for Operational Programme Enterprise and Innovation for Competitiveness 2014 - 2020
MA EI	Managing authority for Operational Programme Enterprise and - Innovation 2007 - 2013
MCS	Management and control system(s)
MoE	Ministry of Environment (<i>Ministerstvo životního prostředí</i>)
MoIT	Ministry of Industry and Trade (<i>Ministerstvo průmyslu a obchodu</i>)

MS2014+	National monitoring system for implementation of programmes in Czechia for 2014 -2020 programming period
OP	Operational Programme
OP HRE	Operational Programme Human Resources and Employment
OP EIC	Operational Programme Enterprise and Innovation for Competitiveness
OP PA	Operational Programme Prague - Adaptability
SME	Small and medium-sized enterprise

1. LEGAL BASIS

The legal basis for the co-ordinated audit mission is Article 75 (1) and (2) of Regulation (EU) No 1303/2013, Article 72 of Council Regulation (EU) No 1083/2006.

2. OBJECTIVES

The main audit objectives of this mission were:

Audit objective 1

In relation to the grants signed with companies of the AGROFERT group between June 2011 and July 2018, obtain reasonable assurance that the management and control systems covering the above-mentioned programmes before the entry into force of Financial Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union were compliant with the regulatory framework and functioned effectively regarding the allocation of EU funds, from the approval of the programmes to the implementation phase, focusing specifically to measures in place to avoid conflict of interests;

Audit objective 2

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 2 - Adequate selection of operations and KR 16 – Adequate audits of operations, as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods¹;

Audit objective 3

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 4 – Adequate management verifications and KR 16 – Adequate audits of operations, as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods²;

Audit objective 4

To establish whether there is evidence of conflict of interest in the process of allocating EU funds to programmes or sectors that could favour operations introduced by companies of the AGROFERT group; and

Audit objective 5

To identify and assess changes in the structures, staffing and working procedure of the competent national authorities including the selection committees that might have influenced the attribution processes or the national controls and audits.

The audit covered the period under the Financial Regulation (EU, EURATOM) No 966/2012 of the European Parliament and of the Council of 25 October 2012 (hereafter “Financial Regulation 2012”) up to the entry into force of the Financial Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 (hereafter “Financial Regulation 2018”).

¹ Articles 58-60 of EC Regulation (EU) N° 1083/2006 (in the 2007-2013 programming period) and Articles 72-74 and 123-125 of Regulation (EU) N° 1303/2013 (in the 2014-2020 programming period).

² Articles 58-60 of EC Regulation (EU) N° 1083/2006 (in the 2007-2013 programming period) and Articles 72-74 and 123-125 of Regulation (EU) N° 1303/2013 (in the 2014-2020 programming period).

3. AUDIT SCOPE

The audit focused on:

- The verification of the compliance of the MCS with the applicable regulatory framework and its effective functioning as regards avoiding conflicts of interests;
- The review of the systems and procedures in place with regard to the above-mentioned key requirements 2, 4 and 16 for ERDF, CF and ESF funds allocated to companies of the AGROFERT group under the 2007-2013 and 2014-2020 programming periods.
- A detailed testing of the selected samples of operations for which companies from the AGROFERT group and other possible companies were beneficiaries, at the premises of the concerned programme authorities and/or intermediate bodies; and
- The review of the work done by the audit authority, including system audits and audits of operations, related to these operations.

For ERDF/CF funds, 36 operations were selected for audit from a total of 98 operations for which AGROFERT group companies were granted ESF/ERDF/CF funding. 6 of these operations were added at a second phase and are treated as an exhaustive stratum. The list of the selected operations is at Annex III. The audit population did not contain any operations for which the grants were awarded after 2 August 2018 (i.e. after the entry into force of the new Financial Regulation).

The table below shows an overview of the approved ERDF/CF funding (EU contribution) to the companies of the AGROFERT group, in CZK and in approximate amounts in EUR³, based on information provided by the Czech authorities in November 2018⁴.

Programming Period	MA	Value sample (EU contribution) In CZK	Value population (EU contribution) In CZK	%	Number of operations in sample	Number of operations in the population	%
2007-2013	MoIT	291.344.453,00	416.025.203,00	70%	11	22	50%
2007-2013	MoE	684.273.007,0	799.839.868,45	86%	13	52	25%
2014-2020	MoIT	243.622.416,18	340.519.464,91	72%	10	22	45%
2014-2020	MoE	86.865.838,30	86.865.838,30	100%	2	2	100%
Total		1.306.105.714	1.643.250.374,7	79%	36	98	36%
		EUR 50.624.252	EUR 63.691.875				

³ Indicative exchange rate used in this report: 1 EUR = 25,80 CZK

⁴ Based on the lists provided to REGIO, EMPL and AGRI by the Czech authorities on 30 October 2018, of all operations for which AGROFERT group companies have received co-financing from ERDF/CF/ESF/EAFRD in the 2007-2013 and 2014-2020 programming periods.

For ESF funds, in total, three operations have been audited, i.e. two operations for the 2007-2013 programming period and one operation for the 2014-2020 programming-period. These three operations represent the entire population of ESF operations awarded to the AGROFERT group since 2012, as follows:

Project No	Beneficiary	OP	Project value (CZK)	Award date
16_043/0004636	Synthesia, a.s.	OP Employment	1,899,360.00	1/3/2017
94.00822	MAFRA, a.s.	OP HRE	4,021,162.60	20/5/2013
1.1.00/34415	ACOMWARE, s.r.o	OP PA	753,924.70	21/3/2012
		Total	6,674,447,30	

The concerned ESF and ERDF/CF managing authorities were requested on 4 December 2018 by the Commission and accepted on 6 December 2018 to stop declaring expenditure to the Commission in relation to operations granted to the AGROFERT group companies. . Therefore, the amounts in the tables above, represent the maximum grant value of the 101 operations (98+3) while the amounts already reimbursed by the EU budget for these operations amount to CZK b1.273.290.818 (approx. EUR 49,35 mio) and CZK 3.190.016 (approx. EUR 0,12 mio) for the ERDF and the ESF respectively.

3.1. Audit of common bodies involved in the process of managing and allocating EU funds

The audit of the common (horizontal) bodies was carried out jointly by EMPL, REGIO and AGRI on 8 – 9 January 2019 and 14 – 15 January 2019.

The audit took place at the level of the following common bodies involved in in the process of managing and allocating EU funds to policy priorities and operational programmes:

- ESIF Council (*Rada pro ESI fondy*);
- Council for the Common Strategic Framework (*Rada pro fondy Společného strategického rámce*);
- National Coordination Authority (*Národní organ pro koordinaci*); and
- Management and Coordination Committee (*Řídící a kontrolní výbor*).

The audit covered all aspects related to the process of management and allocation of EU funds, from the approval of the OPs to the implementation phase, for both programming periods, focusing on the involvement of Prime Minister Babis and any perceived conflict of interest. The results, including the findings and recommendations of this part of the audit, are included in section 5.1 of this report.

3.2. Audit of the ERDF and CF projects granted to companies of the AGROFERT Group

For ERDF and the CF, four OPs were covered (two per programming period), managed by two managing authorities, i.e. the Ministry of Environment (hereafter “MoE”) and the Ministry of Industry and Trade (hereafter “MoIT”) and the related intermediate bodies, i.e. the State Environmental Fund (hereafter “SFZP”), Business and Investment Development Agency – CzechInvest (hereafter “CZIn”) and the Agency for Business and Innovations (hereafter “API”). The audit took place at the premises of the managing authorities, intermediate bodies and the audit authority.

The audit work also included a review of the systems and procedures in place with regard to the key requirements mentioned in section 2 of this report, supplemented by detailed testing of a representative sample of operations.

Sample of operations related to KR 2 – Adequate selection of operations

The audit sample was drawn based on the EU contribution from the population of operations granted to the AGROFERT group companies in both the 2007-2013 and 2014-2020 programming periods by the MoE and the MoIT. The extrapolated results are also based on the EU contribution.

Given the small size of the population subject to audit, REGIO auditors applied a random selection method to draw their sample. The sampling method used was the Equal Probability – simple random sampling stratified per managing authority (i.e. 15 operations per managing authority) and programming period. 6 operations were added at a second phase, giving a total of 36 operations in the sample, and are treated as an exhaustive stratum.

The selected operations, by programming period and by operational programme, are listed in Annex III.

Detail of the coverage:

For ERDF and CF, a representative sample of 36 operations was selected from the entire population of 98 operations of the AGROFERT Group companies co-financed by the ERDF/CF from 2011 to 2018, in order to extrapolate the results to this population. The sample covers the managing authorities for both programming periods. Details of the audit coverage in value and in number of operations (per managing authority and per programming period) are provided in the table at point 3 above.

Sub-sample of operations related to KR 4 – Adequate management verifications

For assessing the proper functioning of KR 4, a sub-sample of 10 operations was drawn from the 36 selected operations for KR2. This sub-sample covered 5 operations per managing authority. The list of operations selected is attached in Annex IV.

In addition, for the managing authority at the Ministry of Industry and Trade, REGIO auditors reviewed all tender procedures launched within the reviewed operations for the 2014-2020 programming period and verified the reasons for grant decision modifications.

The sample and sub-sample selected are representative by MA and by programming period and therefore provide a sound basis for extrapolating the conclusions on the adequate functioning of KR 2 and KR 4.

The results, including the findings and recommendations of this part of the audit are included in section 5.2 of this report.

Review of the work carried out by the Audit Authority

For assessing the proper functioning of KR 16, the audit focused on the audit work performed by the audit authority as required by Article 127 of Regulation (EC) No. 1303/2013, concentrating on audits of operations.

The audit work consisted of desk review of the audit authority reports and working papers submitted to the Commission as well as an on the spot visit which included verifying:

- (i) the methodology of the audit authority in order to verify whether its methodology is in line with applicable regulations (namely the CPR), that it provides for the selection of a representative sample of operations to be audited and provides for sufficient coverage of all legality and regularity aspects of the operations, focusing on the detection of potential conflict of interests and potential indications of undue influence on audit work;
- (ii) whether the audit authority's methodology was correctly applied, the audit strategy was complied with and whether there was evidence of any interference regarding the audit strategy and its implementation;
- (iii) a sample of the audit authority's working papers (checklists), in relation to detecting and preventing conflicts of interests with regard to project selection and management verifications;
- (iv) the functioning of the new tool launched in January 2019 for checking ownership structure of beneficiaries by the audit authority and all managing authorities.

3.3. Audit of the ESF projects granted to companies of the AGROFERT group

For the ESF, the audit covered three OPs (two for the programming period 2007-2013 and one for the programming period 2014-2020) and two managing authorities – the Ministry of Labour and Social Affairs and the City of Prague. The audit took place at the premises of the managing authorities and at the level of one beneficiary.

The audit covered all aspects related to the process of management of EU funds, from the approval of the ESF OPs to the implementation phase and for both programming periods 2007-2013 and 2014-2020.

The audit work covered a review of the systems and procedures in place with regard to the abovementioned key requirements in the scope of the audit, including detailed tests on all ESF operations awarded to the AGROFERT group.

Sample of operations related to KR 2 and KR 4

In total, three operations have been audited by EMPL, i.e. two operations for the 2007-2013 programming period and one operation for the 2014-2020 programming-period. These three operations represent the entire population of ESF operations awarded to the AGROFERT group since 2012. Details of the audit coverage in value of operations are provided in the table at point 3 above.

The results, including the findings and recommendations of this part of the audit, are included in section 5.3 of this report.

4. APPROACH

The audit work was carried out in accordance with the methodology set out in the Mission Planning Memorandum and with the Guidance for the Commission and Member States on a common methodology for the assessment of management and control systems in the Member States, including the assessment criteria⁵.

The audit was performed in line with ISSAI 4000 (compliance audit guidelines from INTOSAI)⁶. It involved collecting evidence prior to and during the on the spot missions, reviewing procedures and files, carrying out interviews and reviewing the selection process and management verifications related to the selected sample of operations.

After finalising the on-the-spot work on 15 February 2019, the EC auditors requested additional clarifications from the national authorities by letter [Ares(2019)1057359] of 20 February 2019. This letter suspended the legal deadline set in Article 75(2a) of Regulation (EU) No 1303/2013 until the requested information was partly submitted on 26 February 2019 (Ares(2019)3420031).

Additional information was requested on 4 March 2019, again suspending the deadline set in Article 75(2)(a) and the Member State reply was received on 14/03/2019 through Ares(2019)1698371.

Therefore, taking into account the two requests for additional information, the three-month reporting deadline of Article 75(2)(a) of the CPR was extended by 16 days and expires on 31 May 2019.

⁵ EGESIF_14-0010-final dated 18 December 2014

⁶ [http://www.issai.org/media\(797,1033\)/ISSAI_4000_E_Endorsement_version_June.pdf](http://www.issai.org/media(797,1033)/ISSAI_4000_E_Endorsement_version_June.pdf)

5. FINDINGS AND ACTIONS TO BE TAKEN/ RECOMMENDATIONS

5.1. Common Bodies - Horizontal system findings

Finding 01

Key requirement: 4 – Adequate management verifications

1. Legal basis as regards conflict of interests

Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012

Article 59(1)

Where the Commission implements the budget under shared management, implementation tasks shall be delegated to Member States. The Commission and the Member States shall respect the principles of sound financial management, transparency and non-discrimination and shall ensure the visibility of Union action when they manage Union funds. To this end, the Commission and the Member States shall fulfil their respective control and audit obligations and assume the resulting responsibilities laid down in this Regulation. Complementary provisions shall be laid down in sector-specific rules.

Article 32(3)

Effective internal control shall be based on best international practices and include, in particular, the following:

- a) segregation of tasks;*
- b) an appropriate risk management and control strategy including control at recipient level;*
- c) avoidance of conflicts of interests;*
- d) adequate audit trails and data integrity in data systems;*
- e) procedures for monitoring of performance and for follow-up of identified internal*
- f) control weaknesses and exceptions;*
- g) periodic assessment of the sound functioning of the internal control system.*

Although no definition of conflict of interests is available for shared management, Article 57 provides the elements and criteria under which a conflict of interests should be considered as present:

(1) Financial actors and other persons involved in budget implementation and management, including acts preparatory thereto, audit or control shall not take any action which may bring their own interests into conflict with those of the Union. Where such a risk exists, the person in question shall refrain from such action and shall refer the matter to the authorising officer by delegation who shall confirm in writing whether a conflict of interests exists. The person in question shall also inform his or her hierarchical superior. Where a conflict of interests is found to exist, the person in question shall cease all activities in the matter. The authorising officer by delegation shall personally take any further appropriate action.

(2) For the purposes of paragraph 1, a conflict of interests exists where the impartial and objective exercise of the functions of a financial actor or other person, as referred to in paragraph 1, is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other shared interest with a recipient.

(3) The Commission shall be empowered to adopt delegated acts in accordance with Article 210 setting out what is likely to constitute a conflict of interests together with the procedure to be followed in such cases.

Regulation (EU, Euratom) No 2018/1046 of the European Parliament and of the Council of 18 July 2018

Article 36(3)

3. Effective internal control shall be based on best international practices and include, in particular, the following elements:

(c) avoidance of conflict of interests;

Article 61

(1) Financial actors within the meaning of Chapter 4 of this Title and other persons, including national authorities at any level, involved in budget implementation under direct, indirect and shared management, including acts preparatory thereto, audit or control, shall not take any action which may bring their own interests into conflict with those of the Union. They shall also take appropriate measures to prevent a conflict of interests from arising in the functions under their responsibility and to address situations which may objectively be perceived as a conflict of interests.

(2) Where there is a risk of a conflict of interests involving a member of staff of a national authority, the person in question shall refer the matter to his or her hierarchical superior. Where such a risk exists for staff covered by the Staff Regulations, the person in question shall refer the matter to the relevant authorising officer by delegation. The relevant hierarchical superior or the authorising officer by delegation shall confirm in writing whether a conflict of interests is found to exist. Where a conflict of interests is found to exist, the appointing authority or the relevant national authority shall ensure that the person in question ceases all activity in the matter. The relevant authorising officer by delegation or the relevant national authority shall ensure that any further appropriate action is taken in accordance with the applicable law.

(3) For the purposes of paragraph 1, a conflict of interests exists where the impartial and objective exercise of the functions of a financial actor or other person, as referred to in paragraph 1, is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other direct or indirect personal interest.

Directive (EU) No 2015/849 of the European Parliament and of the Council of 20 May 2015

Article 3(6)

“beneficial owner” means any natural person(s) who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted and includes at least:

b) in the case of trusts:

i) the settlor;

ii) the trustee(s);

iii) the protector, if any;

- iv) the beneficiary, or where the individual benefiting from the legal arrangements or entity have yet to be determined, the class of persons in whose main interest the legal arrangements or entity is set up or operates;
- v) any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means;

Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013

Article 65(1)

The eligibility of expenditure shall be determined on the basis of national rules, except where specific rules are laid down in, or on the basis of, this Regulation or the Fund-specific rules.

Act No 159/2006 Coll., of 16 March 2006 on conflict of interests

Article 2

(1) For the purposes of the Act, "public official" means

a) deputy of the Chamber of Deputies of the Parliament of the Czech Republic,

...

c) member of the government or head of another central administrative authority not headed by a member of the government,

...

Article 3 (1)

Public officials shall refrain from any conduct in which their personal interest may influence the performance of their function. 'Personal interest' means, for the purposes of this Act, any interest which enables a public official, a person close to a public official, a legal entity controlled by a public official or by a person close to a public official, to increase their assets or asset-related or other benefits, or to avoid the loss of asset-related or other benefits or advantages; this shall not apply where the benefit or interest is generally clear in relation to an unlimited number of addressees.

Article 4 (1) and (2)

(1) Public officials as referred to in Section 2(1)(c) to (m) may not

- a) engage in business or another self-employed activity, be a member of the statutory body or the management, supervisory or inspection body of a legal entity that engages in business (hereinafter "legal entity engaged in business"), unless specific legislation provides otherwise, or*
- b) be in a labour-law or similar relationship or in a service relationship other than the relationship in which they operate as a public official.*

(2) The restrictions under Paragraph (1) shall not apply to the administration of the public official's own assets or to activities of a scientific, pedagogical, publicity-related, literary, artistic or sporting nature, with the exception of business activities in these fields.

Article 4(c) (entry in force on 9 February 2017)

It is forbidden to provide a subsidy under the legislation governing budgetary rules or investment incentives under the legislation governing investment incentives to a commercial enterprise in which a public official as referred to in Article 2(1)(c) or the controlled entity of such a public official owns a share representing a holding of at least 25 % in the commercial

enterprise.

Act No 253/2008 Coll., of 5 June 2008 on selected measures against legitimisation of proceeds of crime and financing of terrorism

Article 4(c)

For the purpose of this Act, a beneficial owner shall mean a natural person having factual or legal possibility to realize directly or indirectly decisive influence in a legal person, trust or other legal arrangement without legal personality. It shall be deemed that under the conditions given in the first sentence the beneficial owner is:

for a foundation, institute, trust or other legal arrangement without legal personality a natural person or beneficial owner of a legal person, who is in a position of:

- 1. a founder,*
- 2. a trustee,*
- 3. a beneficiary,*
- 4. a person in whose interests was the foundation, institute, trust or other legal arrangement without legal personality established or is functioning, if a beneficiary is not determined, and*
- 5. a persons allowed to maintain supervision on administration of the foundation, institute, trust or other legal arrangement without legal personality.*

2. Identified facts

- (1) Since 26 October 2013, Mr Babiš has been a deputy in the Chamber of Deputies of the Parliament of the Czech Republic. Mr Babiš served as Minister for Finance and Deputy Prime Minister for Economy from 29 January 2014 to 24 May 2017. Since 6 December 2017 he has been Prime Minister.

The Prime Minister as the head of government provides the main policy orientation to the government, proposes members of the government to the President for appointment and can request the President to recall them. The government proposes the state budget and is also responsible for its implementation. Within limits laid down by law, the government therefore proposes public spending priorities and the allocation of funding to those priorities. The amount of public spending that is later reimbursed by ESI funds forms part of the revenue of the state budget.

The government can also dismiss senior civil servants responsible for EU funds based on the system set out in Article 17 of the Czech Act No 234/2014 Coll., on the Civil Service. For example, in January 2018 the government headed by Mr Babiš dismissed the Deputy Minister at the Ministry of Labour and Social Affairs, responsible for the section dealing with EU funds.

- (2) Mr Babiš was, since 29 January 2014, a member of the Council for the Common Strategic Framework (*Rada pro fondy Společného strategického rámce*), which in December 2014 was transformed into the ESIF Council (*Rada pro Evropské strukturální a investiční fondy*). Both councils are expert and advisory bodies to the government on the coordination of assistance provided from the EU funds. Conclusions of the councils are the basis for further decision making by the ministers responsible further down the cascade for the implementation of EU funds.
- (3) The audit authority is an entity within the Ministry of Finance reporting to the Deputy Minister of Finance.

- (4) Mr Babiš was, during the period when he served as Minister for Finance and Deputy Prime Minister for Economy (from 29 January 2014 until 24 May 2017), the sole shareholder of the AGROFERT group. As the sole owner of the group, he had an economic interest in its success. Although not a direct member of the statutory, management or supervisory body, Mr Babiš as the sole shareholder exercised the functions of the General Meeting and was deciding in this function on the distribution of the profits and appointment and dismissal of the members of the (statutory, management and supervisory) bodies from the group.

During that period, the Czech Act No 159/2006 on Conflict of Interests prohibited a public official, a term that covers members of the government, from being engaged in any business activity or from exercising any other lucrative activity (Article 4(1) of the Act). However, the prohibition shall not apply to the administration of the person's own assets (Article 4(2) of the Act).

Under Union law, a distinction is made between the mere fact of holding shares (even controlling shareholdings), which is not regarded in itself as an economic activity, and the actual carrying on of business, for example through the exercise of a controlling shareholdings in order to intervene in management. Such a distinction is relevant also in the interpretation of the Czech law⁷.

Therefore, it could be concluded that the shareholding of Mr Babiš in the AGROFERT group would be covered by the exception in Article 4(2) of the Czech Act No 159/2006 Coll. on conflict of interests only to the extent that he did not actually exercise control over the group by involving himself directly or indirectly in its management.

In this regard, the Commission services identified the following decision of Mr Babiš as the sole shareholder of the AGROFERT group exercising the function of the General Meeting:

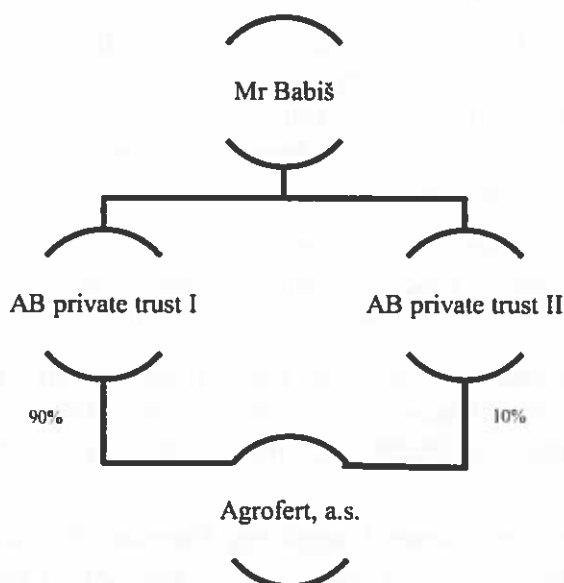
- On 5 May 2014, Mr Babiš decided on the distribution of the profits of the company Agrofert a.s for the year 2013;
- On 23 January 2015, Mr Babiš decided to modify the Statute of the company Agrofert a.s.(e.g. authority of the General Meeting, information flows towards the General Meeting, authority of the Board of Directors and Supervisory Board);
- On 24 June 2016, Mr Babiš decided to modify the Statute of the company Agrofert, a.s (e.g. shares of the company, rights of the shareholders, authority of the General Meeting);
- On 28 July 2016, Mr Babiš decided to extend the period of one person in the Supervisory Board of the company Agrofert a.s;
- On 16 December 2016, Mr Babiš decided to extend the period for seven persons in the Board of Directors and one person in the Supervisory Board and to modify the Statute of the company Agrofert a.s(e.g. shares of the company, rights of the shareholders, sole performance role of the General Meeting role, authority of the Board of Directors and Supervisory Board);
- On 23 December 2016, Mr Babiš decided to dismiss one person from the Board of Directors of the company Agrofert a.s; and

⁷ Decision of the Supreme Administrative Court in the case 14 Kse 1/2017 – 131, points 23 and 35

This confirms that Mr Babiš was involved in the management of the AGROFERT group. Based on this assessment, the Commission services consider that this involvement fell under the prohibition in Article 4(1) of the Czech Act No 159/2006 Coll. on conflict of interests and the exception in Article 4(2) did not apply. However, the Commission services understand that this article did not make an explicit link prohibiting granting public funds, including EU funds, to companies in which the public official was involved.

- (5) Article 4(c) of the Czech Act No 159/2006 on conflict of interests entered into force on 9 February 2017 and prohibited the award of a grant to a commercial enterprise in which a public official or a person controlled by a public official owns at least 25% of the shares of the commercial enterprise.
- (6) On 1 February 2017, Mr Babiš established two Trust Funds (AB private trust I and AB private trust II). All companies of the AGROFERT group were transferred to these Trust Funds on 3 February 2017. The Articles of the Association show that Mr Babiš is the settlor and the sole beneficiary of these Trust Funds.

The AGROFERT group comprises approximately 900 companies, including branches throughout the Czech Republic, Slovakia, Hungary, Poland, the Netherlands, Russia and Germany. The AGROFERT group is one of the biggest companies in the Czech Republic involved mainly in agriculture, food processing and the chemical industry. It also owns two of the country's top newspapers and TV and radio stations.



- (7) The Articles of Association of the Trust Funds and contracts with the trustees confirm the following:
 - The two main objectives of the Trust Funds are (i) the administration of the AGROFERT group and (ii) the protection of the interests of Mr Babiš;
 - Mr Babiš established the Trust Funds for a limited period, principally for the period during which he holds a position as a member of the government;
 - The trustee exercises ownership rights over the assets in the Trust Funds. Mr Babiš is entitled to dismiss the trustee should the trustee breach the rules of the trusteeship or other obligations under the Articles of Association (e.g. if the trustee does not protect the interests of Mr Babiš). The trustee can also be dismissed by the Board of Protectors;

- The trustee can decide how to manage the assets in the Trust Funds, but the trustee cannot:
 - a. approve (or enable) a transformation in which a company that is not member of the AGROFERT group will participate; or
 - b. increase of the equity capital of the companies in the AGROFERT group, unless all the newly issued shares will be acquired by Mr Babiš;

Moreover, the adoption of the following decisions shall be approved by the Board of Protectors:

- c. Distribution of profits of the Trust Funds;
 - d. Exercise of voting rights;
 - e. Disposal of assets in the Trust Funds above the limits set by the Board of Protectors.
- Oversight of the administration of the Trust Funds is performed by the Board of Protectors. The Board of Protectors consists of 3 members appointed by Mr Babiš. The adoption of a decision by the Board of Protectors requires the agreement of all three members;
 - In certain cases (when the Board of Protectors does not designate a protector), Mr Babiš can participate in the meeting of the Board of Protectors and has one vote.
 - Mrs Babišová (wife of Mr Babiš) is a member of the Council of Protectors, considered as the Family Protector. The Family Protector is appointed by Mr Babiš and he can dismiss the person from the position of Family Protector without giving any reason. The Council of Protectors cannot have a quorum without the participation of the Family Protector; and
 - Mr Babiš is entitled to dismiss other Protectors, if that Protector breaches the rules of the trusteeship or other obligations under the Articles of Association (e.g. if the Protector does not protect the interests of Mr Babiš).
 - If the administration of the Trust Funds is terminated, all of the assets of the Trust Funds should be disbursed back to Mr Babiš. Finally, during the administration of the Trust Funds, Mr Babiš may receive any profit from the assets of the Trust Funds.

Article 3(6) of the Anti-Money Laundering Directive (Directive (EU) 2015/849 of the European Parliament and the Council of 20 May 2015) specifies that the beneficial owner in the case of trusts is the settlor, the trustee, the protector or the beneficiary. It means that Mr Babiš is the beneficial owner of the Trust Funds.

- (8) Considering the above governance features, in particular that Mr Babiš has defined the objectives of the Trust Funds (notably the protection of his interests), set up them up and appointed all their actors, whom he can also dismiss, it can be assessed that he has a direct, as well as an indirect decisive influence over the Trust Funds. Based on this assessment, the Commission services consider that, through these Trust Funds, Mr Babiš indirectly controls the parent company of the AGROFERT group (Agrofert a.s.).
- (9) As a consequence, the Commission services consider that Mr Babiš is subject to Article 4(c) of the Czech Act No 159/2006 on conflict of interests. Therefore, the Commission services consider that all grants awarded to the AGROFERT group since 9 February 2017 are not compliant with the national law on conflict of interest prohibiting

provision of a subsidy to such commercial enterprises and therefore with Article 65(1) of the CPR.

This conclusion seems to be supported by the opinion of the Czech Ministry of Justice (ministry responsible for the national Act on conflict of interest) from November 2018 (see Annex V) which confirms:

With regard to the foregoing, we have concluded that, in the case of trust funds, clearly the only situation in which application of the ban laid down in Section 4c of the Conflicts of Interests Act can be considered is a situation where, via a trust fund (and thus indirectly), a decisive influence is exercised over a commercial corporation (the controlled person) which itself owns a share representing a holding of at least 25 % in a commercial enterprise that is to receive grants or investment incentives under the special legislation. As stated earlier, in an environment of control, influence may be exercised directly or indirectly, and thus even via another person or a non-entity (a trust fund, which itself may be the controlling person – for more, see above). However, before reaching a final conclusion on control, it is always necessary to examine, at all levels of control (if influence is being exercised indirectly), whether this influence is decisive in relation to the actions or other behaviour of the controlled person and is directly connected to it; the mere possibility of exercising such decisive influence will also suffice.

At the same time, the analysis of the Ministry of Justice seems to imply that the prohibition in Article 4(c) of the Czech Act No 159/2006 on conflict of interests applies only to the commercial enterprise concerned and not to the controlled person itself. This interpretation would mean that the abovementioned prohibition only applies to companies in which Agrofert a.s company owns at least 25%, not to Agrofert a.s itself. In the view of the Commission services, that interpretation would be overly formalistic.

The Commercial Corporations Act forms part of private law and governs primarily commercial corporations. This could be why the provisions on control mention only commercial corporations and not other entities (with or without legal personality), which could nevertheless also be “controlled” but which are not primary object of the Act.

On the other hand, Act No 159/2006 Coll. on conflict of interests forms part of public law and aims at avoiding a conflict of interests in all its forms. In this context, the term “controlled person” in Article 4(c) of the Act should rather be understood more generally as an entity or a mechanism through which the control is exercised, not confined to the category of commercial corporations within the meaning of Commercial Corporations Act. Such an approach is also supported by the explanatory memorandum of the Act. Otherwise, it would be possible to by-pass the application of that provision simply by establishing a trust, while maintaining actual control over the concerned shares.

On the basis of the above, the Commission services consider that Article 4(c) also applies in a situation where the public official exercises decisive influence over a commercial corporation via a controlled entity that is not a commercial corporation and that does not need to have a legal personality, such as a trust fund.

Considering the above governance features, in particular that Mr Babiš has defined the objectives of the trust funds (notably the protection of his interests), set up their functioning and appointed all their actors, whom he may also dismiss, Mr Babiš currently exercises a decisive influence over the two trust funds.

Mr Babiš therefore controls the two trust funds and, through these trust funds, he also controls the AGROFERT group. Based on this assessment, the Commission services consider that this the AGROFERT group therefore falls under the prohibition in Article 4(c) of Act No 159/2006. Therefore, companies in the group should not have been provided with subsidies and all related public grants, including ERDF, ESF and Cohesion Fund, awarded after 9 February 2017 are in breach of Article 4(c) of Act No 159/2006 on conflict of interests and are considered irregular.

- (10) In respect of the activities of the horizontal bodies (ESIF Council, National Coordination Body, government), the Commission services reviewed various documents (statutes, rules of procedures, minutes of meetings of the committees, supporting documents, decisions taken) related to the work of the above-mentioned common bodies since 2013. The Commission services also analysed the recordings of the meetings held by the ESIF council.

The analysis of these documents and recordings demonstrate that Mr Babiš applies influence over the decisions of these bodies, especially in the decision-making process concerning the allocation of funds between and/or within the operational programmes and in the approval of the measures for the redesign/improvement of the management and control systems of these programmes. Therefore, the management and control system in place did not prevent the allocation of EU funds being affected by conflict of interests, in particular the allocation of EU funds to programmes or sectors that could favour operations introduced by companies of the AGROFERT group. Under EU law, the Czech authorities had an obligation to ensure effective control systems to avoid conflict of interests. The decisions taken by the common bodies have been endorsed at the level of the government.

- (11) The personal and/or economic interest of Mr Babiš can be demonstrated by the following decisions taken in relation to EU funds and from which the AGROFERT group benefited directly or indirectly:

- The National Coordination Authority carries out a risk analysis, identifying the risk of low absorption or lack of absorption of EU Funds by the Operational Programmes. The ESIF Council and the government approved the corrective measures (actions) to be taken by the MAs (e.g. internal re-allocation, increase of the limits in the call for projects, widening of the range of eligible expenditure). This resulted in an increase of the maximum allocation of funds for large companies for the OP Environment and OP Enterprise and Innovation for Competitiveness. The Commission auditors noted that large companies, including some from the AGROFERT group received funding under the programmes;
- In July 2016, a transfer of CZK 2 billion (approx. €78Mio⁸) from the OP Transport to the OP Environment was discussed at the level of the ESIF Council. It should be noted that the OP Transport was already at that time one of the better performing OPs in terms of absorption, while the OP Environment had difficulties meeting the N+3 threshold and hence is at an increased risk of de-commitment. The Ministry of Transport as the MA of the OP Transport opposed this shift of funding during inter-governmental consultations. The arguments raised were however not accepted and the re-allocation of the funds to the OP Environment was approved by the ESIF Council and the Government. Moreover, this transfer proposed by the National Coordination Authority suggested dividing the funds between two

⁸ Exchange rate of 25,80 CZK/€.

measures (sewage systems and air quality improvement in a 50/50 ratio). The Minister for Environment, who is a former chief executive officer of an AGROFERT group company, insisted on a different division between the two measures (sewage systems – 25% and air quality improvement – 75%). These re-allocations favoured the chemical industry sector which, in the Czech Republic, is dominated by AGROFERT group companies.

- (12) The principle and the general obligation on avoidance of conflict of interests in shared management refers to all persons involved in the implementation and management of the EU budget. Therefore, it can be concluded that Mr Babiš has been involved in the implementation of the EU budget in the Czech Republic in the meaning of Article 59(1) read in conjunction with Article 32(3) of the Financial Regulation 2012⁹. Moreover, as of the entry into force of Article 61 of the Financial Regulation 2018¹⁰, a conflict of interest also exists in all those situations where the impartiality and objectivity of a decision is compromised by a personal interest held or entrusted to a given person. Such interest may be of a financial or non-financial nature and it may concern personal, family or economic relations.

Mr Babiš, is the beneficial owner of the AGROFERT group companies and since February 2017, of the two Trusts and has a direct economic interest in the success of the AGROFERT group in the meaning of (i) the definition given by Article 3(6) of Directive (EU) 2015/849 on Anti-Money Laundering, (ii) in the meaning of Article 59(1) read in conjunction with Article 32(3) of the Financial Regulation 2012, during the period in which he was a member of the Government.

3. Conclusions

- a) Mr Babiš was actively involved in the implementation of the EU budget in the Czech Republic;
- b) Mr Babiš is the beneficial owner of the AGROFERT group companies and since February 2017, of the two Trust Funds, which he fully controls and therefore has a direct economic interest in the success of the AGROFERT group; and
- c) the impartial and objective exercise of Mr Babiš functions (as Prime Minister, the Chairman of the ESIF Council, Minister for Finance and Deputy Prime Minister for Economy) was compromised, due to the fact that he was involved in decisions which also affected the AGROFERT group.

On this basis, the Commission services' conclusion is the following:

- 1) For the period before 9 February 2017: Mr Babiš was engaged in business activity and the Czech management and control system did not ensure effective control including the avoidance of conflict of interest as required by Article 32(3) of the Financial Regulation 2012 and with Article 4(1) of the Czech Act No 159/2006 on conflict of interests. In this regard, there was no evidence that any action has been taken at national level in respect of this non-compliance. However, the Commission services understand that this article did not make a specific link prohibiting granting of public funds, including EU funds, to companies in which the public official was involved. No

⁹ Financial regulation (EU, EURATOM) No 966/2012 of the European Parliament and of the Council of 25 October 2012

¹⁰ Financial Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018

financial corrections are therefore proposed by the Commission in respect of this breach of national rules or Article 32 (3) of the Financial Regulation 2012.

- 2) For the period after 9 February 2017, in addition to the Czech authorities management and control systems continued non-compliance with Article 32(3) of the Financial Regulation of 2012 and with Article 4(1) of the Czech Act No 159/2006 on conflict of interests, 17 ERDF and ESF grants (ERDF 16, ESF 1) awarded to AGROFERT Group companies after that date did not comply with Article 4c of the Act No 159/2006. They are therefore irregular. A 100% financial correction should be applied to all related expenditure already declared to the Commission for these operations and the related public contribution from the programmes should also be cancelled. (See Annex II.b). The total value (EU contribution) of the 17 operations affected amounts to CZK 282.719.496, 27 (approx. EUR 10,96 mio) and CZK 949.680 (approx. EUR 36.809) for the ERDF and the ESF respectively.
- 3) For the period after the entry into force of Article 61 Regulation (EU, Euratom) 1046/2018, the deficiency of the management and control system as regards avoidance of conflict of interest continues to exist and in addition needs to ensure compliance with Article 36 (3) and Article 61 of Regulation (EU, Euratom) 1046/2018. Equally, funding awarded in breach of Article 4(c) of the Act No 159/2006 is irregular and a 100% financial correction should be applied.

The Commission auditors did not identify any evidence of undue influence over the audit authority during the period when Mr Babiš was Minister for Finance.

In addition and separately from the issue of conflict of interests, the audit identified individual errors with a financial impact, demonstrating the existence of serious deficiencies in the functioning of the management and control systems for both periods 2007-2013 and 2014-2020 (See sections 5.2 and 5.3).

Action to be taken/recommendation

Recommendations

The managing authorities for the respective operational programmes are requested to:

- (a) Apply a 100% financial correction in respect of all expenditure declared for the 17 operations identified as being in breach of Article 4c of Act No 159/2006 and cancel the related public contribution from the programmes;
- (b) Verify all grants awarded on or after 9 February 2017 for all concerned 2014-2020 operational programmes (i.e. the Environment OP, the Enterprise and Innovation for Competitiveness OP and the ESF OPs) to ensure that they were awarded in compliance with Article 4c of Act No 159/2006 and from 2 August 2018, Article 61 of the Financial Regulation 2018, as concerns possible conflict of interests situations that may have affected grants awarded to any beneficiary. Financial corrections and cancellation of the related public contribution should be implemented for any irregular operations identified by this verification.

- (c) In line with the obligation under Article 36 (3) of Regulation (EU, Euratom) 1046/2018, improve the management and control systems in place to identify any cases of non-compliance with Article 4 (1) and 4c of Act No 159/2006 or Article 61 of the Financial Regulation 2018 to ensure that no further grants are awarded in breach the rules on conflict of interests.
- (d) Advise of any actions taken or proposed to be taken for the non-compliance of Mr Babiš with Articles 4(1) and 4(c) of Act No 159/2006.

Importance: Critical

Body responsible: MAs/CA

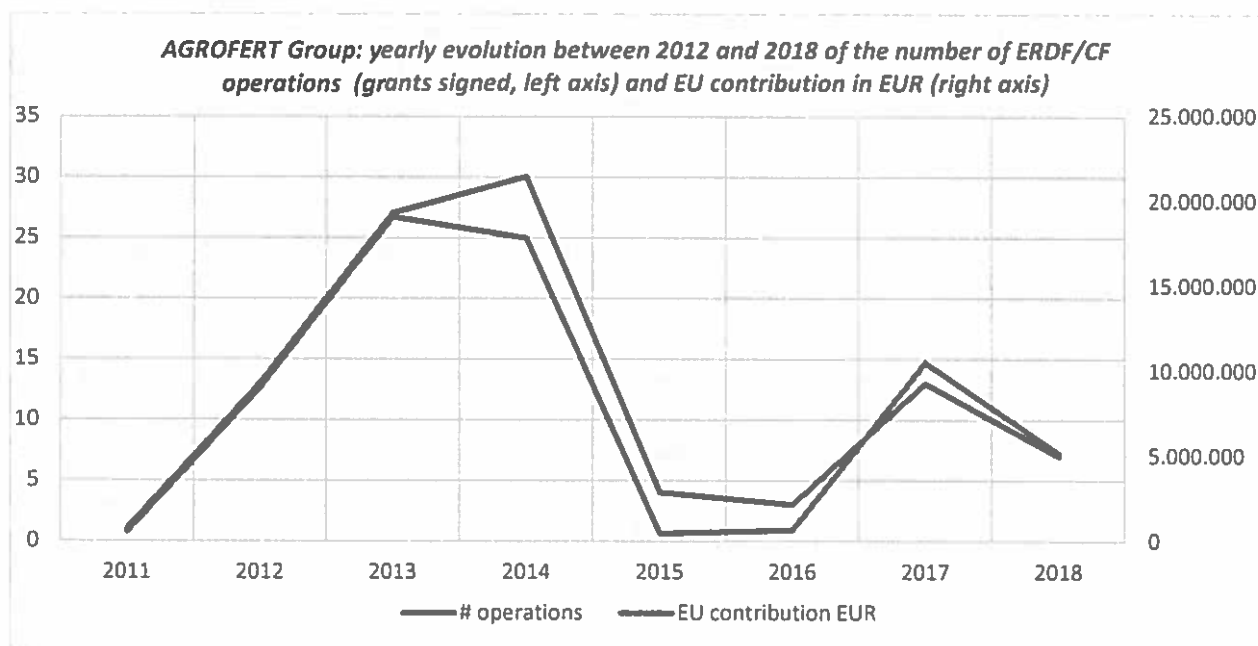
Deadline for implementation: 1 month

5.2. ERDF and CF Findings and actions to be taken / recommendations

On the period from 13 June 2011 until 3 July 2018, companies from the AGROFERT group were granted 98 ERDF / CF operations under four operational programmes (ENV OP 2007-2013 and 2014-2020; Enterprise and Innovation 2007-2013 and 2014-2020).

The table and chart below show the evolution between 2011 and 2018 of the number of operations (grants signed) with companies from the AGROFERT group and the EU contribution for ERDF and CF for these same companies:

<u>Year</u>	Environment Operational programmes			Enterprise and Innovation Operational programmes		
	<u>Number of operations</u>	<u>EU Contribution</u>		<u>Number of operations</u>	<u>EU contribution</u>	
		<u>CZK</u>	<u>EUR</u>		<u>CZK</u>	<u>EUR</u>
-	-			-		
2011	0	0	0	1	13.770.000	533.721
2012	5	7.825.842	303.327	8	226.548.203	8.780.938
2013	19	373.415.551	14.473.471	8	122.143.000	4.734.224
2014	25	410.940.717	15.927.935	5	52.201.413	2.023.311
2015	3	7.657.758	296.812	1	4.005.000	255.233
2016	0	0	0	3	17.033.175	660.201
2017	2	86.865.838	3.366.893	11	186.162.970	7.215.619
2018	0	0	0	7	134.680.907	5.220.190
	54	886.705.707	34.368.438	44	756.544.668	29.323.437



The breakdown per month indicates that for ERDF/CF:

- (i) There was a peak in the value of the AGROFERT group operations grants signed in November 2013 (i.e. before Mr Babiš became Minister of Finance) and in March 2014 (i.e. after Mr Babiš became Minister of Finance). For the grants signed in March 2014, it is reasonable to consider that they have been awarded based on proposals submitted earlier than 29 January 2014.
- (ii) There was a peak in the number of AGROFERT group operations grants signed in June 2014, i.e. when Mr Babiš was Minister of Finance and

5.2.1. Environment OP (2007CZ161PO006) and Environment OP (2014CZ16M10P002)

5.2.1.1. System findings

Finding 02

Key requirement: KR 2 - Appropriate selection of operations

Code of Ethics not implemented in practice in the case of the Steering Committee for the OP Environment in the programming period 2007-2013

The Implementing Document for the Environment OP 2007-2013, approved on 10 November 2008 (further referred to as "the Implementing Document"), lays down the rules to be followed by all stakeholders involved in the implementation of the OP. In particular, Chapter 12 'Code of Ethics', is the *"fundamental ethical standard for the presentation of OP Environment (...) and internal and external staff involved in the implementation of this programme"*¹¹.

¹¹ Implementing Document of the OP Environment, Chapter 12.

The Code sets out and describes the principles of conduct of persons involved in the implementation of the Environment OP (hereinafter "ENV OP"). It lays down the following requirements with regard to the management and disclosure of conflict of interests:

"20. A Member¹² shall refrain from any action that would create a conflict of public interest with his or her private interest.

21. A Member shall not use information related to its activities within the framework of the implementation and functioning of the ENV OP for personal benefit or the benefit of other persons.

22. Where a Member has a private interest in a project to be involved in the implementation of the ENV OP, he/she shall notify the collective body of which he/she is a member or its superior before discussing the matter.

23. In the event of a conflict of interest, where a Member is a project promoter or processor or has been involved in the processing, or has a close family, emotional, economic or political relationship with the promoter or processor, the Member shall not participate in the discussion and assessment of the project".

In accordance with Chapter 12 of the Implementing Document, the Code applies to the following stakeholders:

- *Employees of the Ministry of Environment in its capacity of Managing Authority for the ENV OP;*
- *Other internal staff employed under technical assistance of the ENV OP;*
- *Employees of the Intermediate Body - the State Environmental Fund of the Czech Republic;*
- *External collaborators dealing with the ENV OP;*
- *Members of the Steering Committee of the ENV OP;*
- *Members of the Monitoring Committee of the ENV OP".*

The Steering Committee recommends the selection of the projects and actions supported by the ERDF and the CF on the basis of the project selection criteria approved by the Monitoring Committee and is an *"advisory body to the managing authority, submitting to it proposals and recommendations"*. The Committee initially consisted of 29 members and was subsequently increased to 31 members. The Ministry of the Environment (as managing authority) and the State Environmental Fund (as intermediate body) have representatives in the Steering Committee. Other members are representatives of other Ministries, members of selected Parliamentary and Senate committees, representatives of the Union of Towns and Municipalities of the Czech Republic and of non-governmental organisations.

Based on a review of the documentation related to the setup and the work of the Steering Committee, the auditors identified the following:

i) the rules included in the Code of Ethics have not been reflected in the statute of the Steering Committee;

¹² As defined in Chapter 12 of the Implementing Document, the term 'Member' refers to any 'member of the ENV OP Implementation Structure', i.e. any person involved in the implementation of the ENV OP.

(ii) there is no evidence that the members of the Steering Committee have been made aware of these rules;

(iii) the auditors have not been provided with evidence confirming that these rules were transposed in the Rules of procedure of the Committee.

The managing authority informed the Commission services that the members of the Steering Committee systematically signed declarations of impartiality and confidentiality and provided the auditors with a template of the declaration. The auditors requested copies of the declarations signed by each member of the Steering Committee on their nomination or when participating in the meetings. In reply to this request, six copies of declarations were provided out from at least 53 declarations¹³ due. The auditee explained that it was not able to find a file containing all the requested documents.

For the programming period 2014-2020, the Steering Committee was replaced by a Selection Committee, with similar functions as those for the 2007-2013 period. However, the members of the Steering Committee are obliged by the statutes of the Committee to follow the Code of Ethics, in annex to the statutes, which explains clearly that conflict of interests should be avoided.

Action to be taken/recommendation

Recommendation 02.01

- a) The national authorities are requested to provide the missing declarations of impartiality and confidentiality signed by the members of the Steering Committee mentioned above.

Importance: Very important

Body responsible: Managing authority/Intermediate body acting as the secretariat to the Steering Committee for the 2014-2020 programming period.

Deadline for implementation: 2 months from the final audit report

Finding 03

Key requirement: KR 2 - Appropriate selection of operations

Absence of minimum point's threshold for the evaluation criteria approved by the Monitoring Committee for the OP Environment 2007-2013

According to Article 60 of Council Regulation (EC) No 1083/2006, "*The managing authority shall be responsible for managing and implementing the operational programme in accordance with the principle of sound financial management and in particular for:*

(a) ensuring that operations are selected for funding in accordance with the criteria applicable to the operational programme and that they comply with applicable Community and national rules for the whole of their implementation period"(...)

¹³ During the audit the Commission auditors checked five meetings of the Steering Committee (out of 45 meetings in total, which took place in the period from 2008 to 2015), which were relevant to the selection of the sampled projects. In total, 53 Steering Committee members were identified, who attended those five meetings.

Furthermore, under Article 65 of the Council Regulation (EC) No 1083/2006, *“The monitoring committee shall satisfy itself as to the effectiveness and quality of the implementation of the operational programme, in accordance with the following provisions:*

(a) it shall consider and approve the criteria for selecting the operations financed within six months of the approval” (...)

Absence of minimal threshold - total

The evaluation criteria approved by the Monitoring Committee for measures 5.1 and 2.2 of the ENV OP 2007-2013 did not have any minimum threshold (i.e. a minimum number or percentage of points) that an application should score in order to be recommended for financing.

As a result, all applications for financing within measure 5.1, which fulfilled the eligibility criteria, were recommended and approved for financing.

This absence of a minimum threshold led to a situation where applications with as few as 30 points out of 100 were financed, as was the case in call 26 for some companies that were not part of the AGROFERT group. In the audit sample of AGROFERT group operations, operation CZ.1.02/2.2.00/11.12743 - AGRO Jevišovice was financed having scored 46.75 points out of 100 in the substantive assessment.

Absence of a minimum threshold per selection criteria

Minimum thresholds were not systematically set for individual criteria.

As regards measure 2.2, an application could only be excluded following the substantive evaluation based on the criterion of the cost-effectiveness of the operation. Operation CZ.1.02/2.2.00/11.12743 - AGRO Jevišovice had a value of 999.99 for the financial intensity for reducing emissions criterion. A value of 1000 or more in that criterion would have excluded the operation from financing.

Minimum thresholds for the total number of points and for individual criteria would help to ensure that operations selected for funding meet certain minimum standards and that they are selected in accordance with the principle of sound financial management. Not defining such thresholds may lead to the risk that EU financial resources are used to finance projects of a low quality standard.

Action to be taken/recommendation

The Czech authorities should ensure that, in all future calls, thresholds are set, requesting a minimum number of points per criteria and/or a minimum percentage of the total number of points. Only applications, which reach these minimum thresholds should be approved for funding.

Importance: Very important

Body responsible: Managing authority

Deadline for implementation: next call

Finding 04

Key requirement: KR 2 - Appropriate selection of operations

Ineligible projects due to conflict of interests – 2014-2020 programming period

According to Article 4(c) of Act No 159/2006 of 16 March 2006 on conflict of interests, which entered into force on 9 February 2017:

“It is forbidden to provide a subsidy under the legislation governing budgetary rules or investment incentives under the legislation governing investment incentives to a commercial enterprise in which a public official as referred to in Article 2(1)(c) or the controlled entity of such a public official owns a share representing a holding of at least 25 % in the commercial enterprise”.

Since May 2016, the IB-SFZP legal department verifies the ownership structure with the support of the Arachne IT system, complemented by the use of the Cribis IT system since 1st January 2018: the legal department traces the ownership structure of beneficiaries down to the level of a physical person. However, it does not check whether the identified physical person (e.g. owner of the entity) is a ‘public official’ owning a 25 % or more of a commercial enterprise (Article 4(c) of Act No 159/2006 on conflict of interests).

In this regard, the auditors noted that for project CZ.05.2.32/0.0/0.0/15_008/0001081, the financing agreement was signed with the company Wotan Forest on 31 July 2017, i.e. after the above-mentioned amended Act No 159/2006 entered into application. Similarly, the financing agreement for project CZ.05.3.24/0.0/0.0/16_044/0004552 was signed on 30 August 2017.

Reference is made to the system finding 1 above, which concludes that for the period after 9 February 2017, in addition to Mr Babiš continued non-compliance with Article 4(1), grants awarded to AGROFERT Group companies after that date did not comply with Article 4c of the Act No 159/2006. They are therefore irregular and a 100% financial correction should be applied to all related expenditure declared to the Commission for these operations.

In the case of the two above-mentioned projects, the Legal Department stopped its investigation at the level where it obtained the name of the final owner. However, it did not conclude on any conflict of interests.

Therefore, the auditors conclude that the potential conflicts of interest are not adequately verified according to Article 4(c) of Act No 159/2006 on conflicts of interest and the two above-mentioned projects are ineligible.

Action to be taken/recommendation

- (a) The managing authority is requested to correct the expenditure already declared to the Commission in respect of this operation and to cancel the public contribution to it (see recommendation under finding 1).
- (b) The managing authority is requested to ensure that the legal department verifies whether the identified physical person (e.g. owner of the entity) is a ‘public official’ owning a 25 % or more of a commercial enterprise (Article 4(c) of Act No 159/2006 on conflict of interests).

Importance: Critical

Body responsible: Managing authority

Deadline for implementation: 1 month

Finding 05

Key requirement: KR 2 - Appropriate selection of operations

Assessment criteria: AC list

Timing and scope of non-conflict of interest declarations signed by the employees of MA and IB for OP Environment / programming periods: 2007-2013 and 2014-2020

When entering in service and signing their employment contract, the IB-SFZP and MA staff (e.g. internal evaluators/project managers/financial managers) signed a declaration of independence and a code of conduct.

However, for the programming period 2007-2013, staff were not requested to confirm the absence of conflict of interests prior to the evaluation of a particular project application.

For the programming period 2014-2020, the IT system has been adapted and the staff assigned to evaluate an application must first formally confirm, by ticking a box within the IT system, that they are not in a situation of conflict of interests. However, the auditors could not obtain assurance that by accepting an evaluation task for a particular application, the staff are fully aware of the meaning of a conflict of interests and of the consequences if they unduly accept a task.

Action to be taken/recommendation

The MA/IB should ensure that by ticking the box declaring the absence of conflict of interests before accepting to evaluate an application, staff are made aware of (i) the definition of a conflict of interest and (ii) the consequences for the staff it may have if they unduly accept an evaluation task.

The declarations should only be signed by an evaluator following a review of all information available on both the applicant and the project. The IT system should contain a record of the declarations signed at each stage by each employee.

Importance: Important

Body responsible: managing authority/intermediate body

Deadline for implementation: 3 months

5.2.1.2. Findings on the operations

Finding 06

Lack of audit trail of the decisions taken in the selection process (measure 5.1) / - programming period: 2007-2013

For the programming period 2007-2013, in the case of all nine operations sampled for measure 5.1, there is no supporting documentation underpinning the opinion of the Ministry of Environment (*Stanovisko MZP*) concerning the technical and environmental evaluation of the applications (substantive evaluation stage). This opinion is the main document supporting the substantive evaluation of the applications.

The Ministry of Environment informed the auditors that the two employees who drafted the opinions for these nine projects have since retired. In one case out of the nine (project CZ.1.02/5.1.00/12.16959 - PREOL), the current manager was able to explain how the former employee performed the evaluation and to demonstrate how the opinion given was justified.

The Commission auditors reviewed the annexes to the project application to re-perform the remaining eight¹⁴ substantive evaluations. Based on documentation provided by the Ministry of Environment (i.e. independent expert opinions, feasibility studies, cost estimates) the auditors confirmed that the operations fulfilled the technical and environmental selection criteria and were correctly selected for financing. Some minor differences in the evaluations re-performed by the Commission auditors would not have any impact on the selection of the operations, as there were no minimum number of points required for that measure and all the applications which fulfilled the eligibility criteria were financed.

Moreover, the auditees did not provide the Commission auditors with any benchmark/guidance given to the evaluators on how to assess the selection criteria where the assessment questions were constructed in a general way, for example:

Example 1: Question on the assessment of the level of risk: 3 replies were possible: (i) Project to a large extent contributes to risk reduction; (ii) Project partly contributes to risk reduction; (iii) The project does not contribute to risk reduction.

Example 2: Question 2 on technical criteria: Cost of the project compared to standards and with other projects of similar character is (i) adequate, (ii) more expensive or (iii) too high.

The lack of adequate audit trail reduces the transparency of the selection process.

Action to be taken/recommendation

The 2007-2013 programming period is closed. However, for the current and future programming periods, the Czech authorities should ensure that an adequate audit trail is kept for the evaluation process of future calls, to ensure that all stages of the grant evaluation process are adequately documented and that these documents are readily retrievable.

In order to ensure equal treatment of all applicants, clear guidance should be issued to ensure that evaluators have a common understanding of how to evaluate each selection criterion.

Importance: Very important

Body responsible: managing authority

Deadline for implementation: next calls

Finding 07

Contract awarded to a linked company – programming period 2007-2013

The selection committee of the company AGRO Jevišovice (beneficiary of project CZ.1.02/2.2.00/11.12743), acting as a contracting authority, awarded a contract to the company AGROTECHNIC Moravia company. AGROTECHNIC Moravia is owned by NAVOS a.s., which in turn belongs to the AGROFERT Group and since 22 June 2010 is the sole shareholder of AGROTECHNIC Moravia company.

AGROTECHNIC Moravia was selected on 24 February 2012, i.e. before Mr. Babiš entered the Czech government. In line with the only criteria (i.e. lowest price), the selection

¹⁴ CZ.1.02/5.1.00/13.19180 – Cerea; CZ.1.02/5.1.00/13.20380 – Lovochemie, CZ.1.02/5.1.00/13.19176 – Navos; CZ.1.02/5.1.00/12.17046 – Primagra, CZ.1.02/5.1.00/12.16956 – Synthesia, CZ.1.02/5.1.00/13.20367 – Synthesia, CZ.1.02/5.1.00/11.13433 – VUOS, CZ.1.02/5.1.00/13.19151 – VUOS.

committee of AGRO Jevišovice awarded the contract to the bidder providing the cheapest eligible offer.

The value of the contract (CZK 4.545.000 approx. EUR 176.000) was below the applicable EU public procurement thresholds but fell under the high-value threshold category 1 (*"ZVH 1"*) of the Czech legislation on procurement. The award of the contract needed to comply with the provision of the Ministry of Regional Development Regulation's *'Binding procedures for the award of contracts co-financed by EU resources not covered by Act No 137/2006 on public procurement, in the 2007-2013 programming period'*.

The applicable award procedure for contracts with a higher value of category 1 entails the following steps:

- (i) a call for tenders seeking a minimum of 5 candidates for the submission of a bid;
- (ii) a deadline for submission of bids of at least 15 days from the date of dispatch of the request to submit the offer;
- (iii) the setting up of a tender evaluation committee of at least 3 members;
- (iv) the drafting of minutes of the meetings signed by the tender evaluation committee, including the recommendation of the most advantageous bid and
- (v) informing all tenderers on the outcome of the selection procedure and of the conclusion of a contract.

In line with this procedure, the tenderer requested offers from 5 companies, of which 3 belong directly or indirectly to the AGROFERT group, i.e. Navos a.s., AGROTECHNIC Moravia and KVARTO.

Out of the 5 offers requested:

- (i) Although the offer of NAVOS, a.s, was the cheapest offer before its exclusion, it was excluded due to lack of fulfilment of the technical criteria;
- (ii) The offers sent by ALS AGRO (a company not linked to the AGROFERT Group) and KVARTO (owned by ZZN Pelhřimov a.s., which belongs to AGROFERT Group) were not selected as their offers were more expensive than the cheapest eligible offer;
- (iii) AGROSERVIS ZAMEL, s.r.o. did not send any offer (the auditors could not establish whether this company belonged to the AGROFERT Group);
- (iv) AGROTECHNIC Moravia was selected in line with the only award criterion (i.e. lowest price).

The award process was in line with the applicable procedure. However, the fact that AGRO Jevišovice, as tenderer, requested Navos a.s., AGROTECHNIC Moravia and KVARTO to submit an offer may constitute a conflict of interests as these three companies had financial links with AGRO Jevišovice via the AGROFERT Group. This approach is not in line with the principle of sound financial management, in particular with the basic principle of transparency. The offers from three linked companies within the same group as the contracting company cannot be considered as independent offers.

Action to be taken / recommendation

recommend also the programme authorities

The finding relates to the 2007-2013 period. For the future, programme authorities are requested to clarify in the award procedure to require a minimum of 3 to 5 independent offers, meaning from independent, non-linked companies, in line with the principle of sound financial management.

Importance: Very important

Body responsible: Managing authority/intermediate body

Deadline for implementation: 3 months

5.2.2. Enterprise and Innovation for Competitiveness OP (CCI 2014CZ16RFOP001) – Programming Period 2014-2020

Please note that KR 2 - Appropriate selection of operations was reviewed also during REGIO's Early Preventive System Audit mission no REGC414CZ0018 carried out from 20 - to 24 February 2017.

The system findings detected by REGIO's Commission services during the EPSA mission no REGC414CZ0018 are also relevant for this audit. The purpose of this mission is not to repeat the findings already communicated by the Commission services to the Czech authorities in the Final audit report (ref. no Ares(2017)4403176 of 08 September 2017). Therefore, for the findings detected earlier, we refer to that audit report. Nevertheless, partial overlaps are possible, where there are new elements.

The Commission services identified the system deficiencies listed in the following findings.

5.2.2.1. KR2 - System findings

Finding 08

Key requirement: KR 2 - Appropriate selection of operations

Selection criteria not sufficiently defined

Under Article 110 of the CPR, the monitoring committee shall examine and approve the methodology and criteria used for selection of operations.

The selection criteria for Call for operations no 01_15_014 Innovations were approved by the monitoring committee on 28 May 2015. However, the methodology and selection criteria were not sufficiently defined. There was no guidance on what aspects should have been taken into account by the evaluators during the operation evaluation or on how the information provided in the operation application should have been assessed and points allocated. See also findings 15.

This led to numerous cases, where the MA EIC needed to use a third expert (32% of all operations assessed during the substantive evaluation), where one expert recommended an operation for financing and the second expert did not. In some cases the difference in points assigned was more than 40 points out of a total possible of 100 points (e.g. operation no CZ.01.1.02/0.0/0.0/15_014/0000245 'Inovace medových výrobků' – first evaluator assigned 29 points, the second evaluator 73 points and the third evaluator 43 points).

Action to be taken/recommendation

Recommendation

The MA EIC should ensure for all future calls for operations under the 2014 – 2020 OP EIC that the methodology and the selection criteria are clearly defined and that adequate instructions and training are provided to evaluators.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Finding 09

Key requirement: KR 2 - Appropriate selection of operations

Verification of ownership structure not carried out for large enterprises

The Commission auditors noted that the managing authority limited their verifications of the ownership structure of applicant companies only to SMEs and did not verify this aspect for large enterprises. This was due to a focus on the compliance of SMEs with State aid rules rather than for conflict of interests purposes.

When assessing the ownership structure of the applicant, the Czech authorities relied on the information submitted in the applicant's self-declaration (*'T2A_2_F_Prohlášení k žádosti o podporu'*). Where the applicant declared itself to be a large enterprise, the MA EIC / IB API did not perform any checks of the ownership structure or on the beneficial owner of the applicant, as this was not relevant for any increased co-financing rate which was only available to SMEs (i.e. for Call II for Energy savings the EU co-financing rate represented 50 % for small enterprises, 40% for medium enterprises and 30% for large enterprises).

Correspondence between the intermediate body and the applicant (*'Interní depeše'*) shows that the intermediate body treated the submission of the self-declaration as a formality and did not verify it¹⁵.

The Commission takes note that the related methodology for the in-depth verifications of ownership structure for SMEs is in force since 1 January 2018. Since then the ARACHNE tool is also used. However, this new methodology does not include any verification of the ownership structure of large enterprises.

The partnership agreement states in chapter 2.5:

'The aim for the 2014-2020 programming period is to minimise the risk of occurrence of fraud and corruption behaviour by establishing suitable preventative measures, mechanisms for detecting fraud and preventing its recurrence.[...]. The following were identified as main problem areas: selection and evaluation of operations, awarding public tenders, carrying out control activities and setting up management processes for individual parties involved in the implementation.'

'With respect to the transparency principle and to prevent potential conflict of interests, applicants will be obliged to disclose their ownership structure based on the proportionality principle according to the methodological guideline specifying the area of financial flows when submitting their grant applications or during the operation selection process. Applicants at risk of conflict of interests or who will not be able to prove their ownership structure will be excluded.'

Therefore, ownership structure should be verified to identify potential conflict of interests.

In this regard, the Commission services noted that the beneficial owner mentioned in the grant applications for operations (see footnote 13) submitted within the Call for operations no 01_16_061 (Energy savings) does not correspond to the beneficial owner mentioned in the Statute of AB private trust I and II. The beneficial owner specified in the applicant's self-declaration (*'T2A_2_F_Prohlášení k žádosti o podporu'*) was the trustee of these funds. As

¹⁵ Operations no CZ.01.3.10/0.0/0.0/16_061/0011139, CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152, CZ.01.3.10/0.0/0.0/16_061/0011875 and CZ.01.3.10/0.0/0.0/16_061/0011988

indicated in finding no 1, the Commission services consider that Mr Babiš is the beneficial owner of the AB private trust I and II. This issue was not identified by the management verifications.

Action to be taken/recommendation

Recommendation 09.01

The programme authorities are requested to review the ownership structure for all types of beneficiary, including large enterprises, at least on a sample basis and to specify in their methodology a procedure for the selection of applicants who would be requested to submit supporting documents proving their ownership structure including the beneficial owners. It is recommended to carry out this selection based on a risk assessment. However, an element of randomness should also be considered.

In this respect, the programme authorities are also recommended to consider obliging applicants/beneficiaries, at the time of submission of the application or before the grant agreement is signed, to provide details of the ownership structure in order to ensure that sufficient information is available for the subsequent risk analysis.

In addition, the OP methodology should also include sufficient instructions explaining how verification of the ownership structure shall be carried out, taking into account risks related to this area (e.g. several layers of the companies, companies from abroad), specifics of different types of companies and requirements set in the relevant EU and national legislation.

As from now, the programme authorities are requested to review the ownership structure up to the level of the ultimate beneficial owner, in particular in the case of trusts but also for subsidiaries to the large groups.

Recommendation 09.02

As a significant number of operations have already been selected, the Czech authorities are requested to verify the ownership structure of all large enterprises selected to date to ensure that any conflict of interest issues are identified.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Finding 10

Key requirement: KR 2 - Appropriate selection of operations and KR 4 - Appropriate management verifications

Risk assessment at operation level – lack of procedures for the identification of risky operations at the selection stage and their later verification during management verifications

The Commission services noted that the internal or external evaluators raised during the selection of operations certain concerns/risks with potential impact on the operation implementation. However, this information was not recorded and used for the risk analysis of the operation for the purposes of planning on-the-spot checks by the MA EIC.

For example, for the operation no CZ.01.1.02/0.0/0.0/15_014/0000516, one of the internal and one of the external evaluators listed certain risks during the operation evaluation and commented that those elements should be incorporated into the grant agreement as a condition

for co-financing from the EU funds and checked during operation implementation. However, this information was not included in the grant agreement or later used by the MA EIC / IB API for their management verifications.

Action to be taken/recommendation

Recommendation 10.01

The MA should set up a system where the risks identified during the selection of operations are recorded, stored and followed up in the later stage during the management verifications at all levels (i.e. MA EIC / IB API).

Recommendation 10.02

The MA EIC is requested to verify all cases where the evaluators identified risks / conditions for funding and carry out appropriate management verifications in relation to these cases.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Finding 11

Key requirement: KR 2 - Appropriate selection of operations

1. Inadequate evaluation of criterion "Cost-effectiveness of budget" (*hospodárnost rozpočtu*) – unequal treatment of operations

The Commission services identified a weakness in the evaluation of the criterion '*cost-effectiveness of the budget*' in relation to 5 operations implemented by the beneficiary *Cerea, a.s.* The purpose of this criterion is to assess whether the operation budget corresponds to market prices (i.e. whether the budget corresponds to the normal and standard prices).

Based on a methodology for the verification of market prices, the MA EIC compares the official registers of standard prices (available mainly for items in construction works) or indicative offers from the potential suppliers submitted by the applicant.

In line with the methodology, where a technology supply is part of the operation, the applicant should present the indicative offers from the potential suppliers in the grant application, if such indicative offers exist. At the same time, the operation must include a detailed description of the technology to be purchased, including the technical specification and a breakdown of the price.

Annex 3 ('*Evaluation model and criteria for evaluation and selection of operations*') to the call for applications 01_16_061 provides that:

'In this category, the evaluator assesses the intention of the applicant and compares it with specific actions within the operation; assess whether the proposed costs correspond to the operation and whether they are reasonable at place and time to price. The budget of the operation shall include a detailed breakdown of eligible and non-eligible expenditure. The proposed expenditure must be necessary for the implementation of the operation and must be linked to the activities of the operation. Costs must reflect the principles of effectiveness and efficiency.'

If the evaluator considers that the operation budget is excessive, a reduction should be suggested. However, neither the methodology for the verification of market prices, nor the

evaluation criteria, nor other available documentation provides instructions to the applicants/evaluators on:

- how many indicative offers should be presented;
- how the price from indicative offers should be considered for the '*cost-effectiveness of the budget*' (the lowest price or the average price); and
- how to treat a conflict of interests in the case of indicative offers.

The Commission services was informed that the lowest price resulting from the submitted indicative offers is considered for the "*cost-effectiveness of budget*". However, in some cases, (no examples were provided by the MA EIC) the MA EIC can take into account the average price. Based on a review of the audited operations, the Commission services identified the following:

- In the case of three audited operations (CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152 and CZ.01.3.10/0.0/0.0/16_061/0011875), an average price was used (i.e. calculated as an average from the submitted indicative offers for the technology part);
- In operation no CZ.01.3.10/0.0/0.0/16_061/0011988 a price higher than average was used;
- For operation no CZ.01.3.10/0.0/0.0/16_061/0011139 the highest indicative offer was taken into account.

Moreover, for the same operation an ineligible amount (154.964,40 CZK or approx. EUR 6.006) was identified and deducted. However, this deduction was not taken into account for the assessment of the criterion "*cost-effectiveness of budget*".

The observations identified above clearly show that there was not a consistent approach on how to evaluate the criterion "*cost-effectiveness of budget*". As a consequence, this led to unequal treatment of the applicants as the indicative offers were evaluated differently in each application.

Moreover, the person responsible for verification of the criterion "*cost-effectiveness of budget*" is different from the evaluator for the rest of the application, which is not in line with the methodology of the MA EIC.

Finally, the evaluator should also "*assess whether the budgeted costs are in line with the action*" under the criterion in question. However, the Commission services noted that this assessment is not carried out by the MA EIC at all.

2. Inadequate evaluation of Criterion "*Cost-effectiveness of budget*" (*hospodárnost rozpočtu*) – non existing rules for indicative offers

The Commission services identified that for all applications submitted by the applicant *Cerea, a.s.* within the Call II for Energy savings, the indicative offers were submitted by only two companies (*Commercial společnost s.r.o.* and *Farmtec a.s.*), and in case of operation no CZ.01.3.10/0.0/0.0/16_061/0011988 also by the company *AGROING BRNO s.r.o.*

The company *Farmtec, a.s.* is a subsidiary of *Agrofert a.s.* . The applicant *Cerea, a.s.* is also subsidiary of *Agrofert a.s.* As indicated under the point 1 of this finding, in the Call for operation rules, there are no procedures on how to treat a conflict of interests for the indicative offers submitted. The MA EIC explained that there is no risk for the EU budget in relation to the indicative offers, as the real price results from the tender procedures.

The Commission services do not share the position of the MA EIC for the following reasons:

- At the selection stage for all operations of the *Cerea, a.s.*, the indicative offers submitted by the company *Farmtec a.s.* were always higher than the offers submitted by the companies *Commercial společnost s.r.o.* or *AGROING BRNO s.r.o.* (i.e. both companies do not belong to the AGROFERT group). For example in the case of operation no CZ.01.3.10/0.0/0.0/16_061/0011988, the difference between the offer submitted by *Farmtec a.s.* and *Commercial společnost s.r.o.* was 69%. The difference between *Farmtec a.s.* and *AGROING BRNO s.r.o.* was 32%. Therefore, this system allows for artificial increase of the budget of the operations.
- At the later stage of the selection of supplier, neither the company *Commercial společnost s.r.o.* nor *AGROING BRNO s.r.o.* were requested to submit a bid in the tender procedure described in finding 12. This approach is not in line with the principle of sound financial management.

Moreover, the Commission services also identified that the applicant *Cerea, a.s.* was represented during the selection process and the operation implementation by a representative of the company *Farmtec, a.s.*, Mr DB. However, the representative of the *Cerea, a.s.* for the purposes of the operation was Mr Po as indicated in the project application. This indicates non-transparency of the whole process as *Farmtec, a.s.* (including its employee Mr BB) participated in creating the prices for the operation in question.

Therefore, the indicative offers presented by *Farmtec a.s.* should not be taken into account by the MA EIC / IB API as offers provided by independent suppliers. It is evident that *Farmtec a.s.* closely cooperated during the preparation and implementation of the operations in question.

Action to be taken/recommendation

Recommendation

The MA EIC should ensure that indicative offers are provided by independent companies and that they are reasonable compared to market prices. In addition, the MA EIC should assess whether the proposed type of costs corresponds to the operation.

The MA EIC is requested to ensure that a minimum number of offers (e.g. 3 to 5 offers) are submitted from contractors independent of the procuring company, in line with the principle of sound financial management.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

5.2.2.2.

KR 4 - System findings

Finding 12

Key requirement: KR 4 - Appropriate management verifications

Conflict of interests between the contracting authority and the supplier:

The IB API detected a potential conflict of interest during its verification of the tender procedures within operations no CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152 and CZ.01.3.10/0.0/0.0/16_061/0011988 launched by

the beneficiary *Cerea, a.s.*, between the *Cerea, a.s.* (acting as contracting authority) and the winning company *TIS – CR s.r.o.* (not member of the AGROFERT group).

The beneficiary *Cerea, a.s.* is a private company. However, the basic principles of transparency, equal treatment and non-discrimination are transposed into the detailed binding national '*Rules for selection of suppliers*' and are applicable to such companies.

A Vice-Chairman of the Board of Directors of *Cerea, a.s.*, is a brother of an executive of the limited liability company *TIS – CR s.r.o.*, which won the 3 tenders within the three operations. The company *TIS – CR s.r.o.* was the only bidder in these tenders.

All three contracts with the company *TIS – CR s.r.o.* were signed on 18 April 2018. On 2 July 2018, the IB API concluded that the beneficiary had breached point 55 of the '*Rules for the selection of suppliers*' in force since 2 May 2017.

In accordance with point 55 of the above mentioned Rules:

'the contracting authority shall refrain from any action, which could lead to a conflict of interest in the award and performance of the public contract, in particular at the time of the preparation of tender documents, during the evaluation of the bids, when the contract is signed.'

'There is a conflict of interest where for the family reasons, for reasons of emotional ties (such as a close person under Section 22 of Act No 89/2012 Coll., the Civil Code), for reasons of economic interest (...) or for reasons of other common interest, the impartial and objective performance of the contracting authority's activities in tender procedure is compromised. Where such a risk exists, the contracting authority/entity shall refrain from doing so and shall notify the MA without delay. The MA decides whether or not there is a conflict of interest.'

The IB API concluded that there is a conflict of interest and proposed 100% financial correction.

On 20 July 2018 the contracting authority terminated all three contracts with the winning bidder and on 25 July 2018 launched three new tenders. The contracting authority again published the tender procedure on its website profile and in addition contacted 5 potential bidders by email. One of the contacted bidders was again company *TIS – CR s.r.o.* Similar to the initial tender procedure, only one bid by the company *TIS – CR s.r.o.* was submitted for each of the three tenders.

The IB API was later requested by the beneficiary to provide its opinion on whether the contract with the winning bidder, company *TIS – CR s.r.o.* could be signed. Mr J.P., a head of department in the IB API, replied on 21 September 2018 to the beneficiary, represented by the same employee of *Farmtec a.s.* as in finding 11, that the MA OP EIC opinion was being sought. On 11 October 2018, the same person, Mr Pi, that time in the position of the Head of Unit in the MA agreed with the signing of the contract. Mr Pi in his email of 11 October 2018 addressed to the IB API explained that by repeating the tender and performing extra effort to receive more bids; the beneficiary did maximum for the transparency of the tender. Nevertheless, the contract signature took place already on 21 September 2018, i.e. before a formal decision was taken by the MA EIC.

For the two remaining operations implemented by *Cerea, a.s.* no CZ.01.3.10/0.0/0.0/16_061/0011139 and CZ.01.3.10/0.0/0.0/16_061/0011875, the potential conflict of interest due to the family links explained above was not detected by the staff of the IB API. Therefore, the contract between *Cerea, a.s.* and *TIS – CR s.r.o.* was never terminated and the issue of potential conflict of interest was never raised for these two operations. This

also demonstrates the unequal quality of procedures within this IB API (previous staff of the IB API did not detect this issue).

Commission auditors do not agree with the conclusion of the MA EIC of October 2018 to go ahead with the signature of the contract with *TIS – CR s.r.o.* due to the following reasons:

- When re-launching the procedure, the beneficiary again directly contacted *TIS – CR s.r.o.* which was subject to the conflict of interest;
- Another 4 companies (*BEDNAR FMT s.r.o.*, *JK Machinery, s.r.o.*, *PAWLICA, s.r.o.* and *Kovodružstvo, výrobní družstvo Strážov*) contacted by the beneficiary did not submit a bid;
- The beneficiary did not contact the companies that presented indicative offers for the operation application (*Commercial společnost s r. o.* or *AGROING BRNO s.r.o.*) or companies that had already delivered the same type of product to the beneficiary in the past (*SIAGRA s.r.o.*) ;
- Based on an analysis of the indicative offers, the price offered by the company *TIS – CR s.r.o.* was substantially higher than the indicative offers. For operation CZ.01.3.10/0.0/0.0/16_061/0011988 the indicative offer submitted by the company *Commercial společnost s r. o.* amounted to 4 012 000 CZK for the technology part and the price presented by company *TIS – CR s.r.o.* amounted to 5 360 000 CZK, i.e. 34% higher; and
- The role of the representative of *Cerea, a.s.* Mr DB, currently an employee from another AGROFERT group company, *Farmtec, a.s.*, is unclear and non-transparent.

Therefore, Commission auditors consider that a conflict of interests between the beneficiary and the company *TIS – CR s.r.o.* was also present during the second tender, that the conflict was inadequately mitigated by the beneficiary and the company *TIS – CR s.r.o.* won the contract.

Action to be taken/recommendation

Recommendation

The MA EIC should apply a financial correction of 100% for the abovementioned contracts in line with point 21 of the *Guidelines for determining financial corrections to be made to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement*, related to established cases of conflict of interests and cancel the related public contribution.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Finding 13

Key requirement: KR 4 - Appropriate management verifications

Non-transparent publication of tender proceedings:

It is acknowledged that the majority of the procurement contracts in the OP EIC is not subject to the EU / national public procurement law (private companies with public funding below

50%). However, the basic principles of transparency, equal treatment and non-discrimination are transposed into the detailed binding national *'Rules for selection of suppliers'*.

In accordance with the *'Rules for the selection of suppliers'* valid from 2 May 2017 the tender procedure shall be initiated by the publication of a tender notice on the **contracting authority's profile**. A contracting authority's profile is an individual website profile (internet address), where each beneficiary publishes his tenders. The internet address of the contracting authority is required to be published in the Public Procurement Bulletin.

The search in the Public Procurement Bulletin for tender procedures that do not fall under the Czech Act no 134/2016 Coll. on the award of public contracts, is based only on the name of the contracting authority or its company registry code. A search using other criteria such as CPV code or the subject of the tender procedure, is not possible.

It means that the tender notices related to tender procedures, which do not fall under Act no 134/2016 Coll., on the award of public contracts, are not published centrally in the Public Procurement Bulletin and/or website of the OP EIC. In reality, it means that potential suppliers must monitor on a regular basis individual profiles of each contracting authority. This leads to a restriction of competition for tenders published under the OP EIC, non-transparent procedures and to the increased number of single bids as shown in the table below:

Operation No	Tender	Estimated value	Number of submitted bids	Winning bidder
CZ.01.3.10/0.0/0.0/16_061/0011139	Cerea - Sušárna zrnin Havlíčkův Brod	9 000 000 CZK	1	TIS – CR s.r.o.
CZ.01.3.10/0.0/0.0/16_061/0011143	Cerea - Sušárna zrnin Chotěboř	10 000 000 CZK	1	TIS – CR s.r.o.
CZ.01.3.10/0.0/0.0/16_061/0011152	Cerea - Sušárna zrnin Říkov	10 000 000 CZK	1	TIS – CR s.r.o.
CZ.01.3.10/0.0/0.0/16_061/0011875	Cerea - Sušárna zrnin Dobřenice	10 000 000 CZK	1	TIS – CR s.r.o.
CZ.01.3.10/0.0/0.0/16_061/0011988	Cerea - Sušárna zrnin Jičín	7 000 000 CZK	1	TIS – CR s.r.o.

In the view of Commission's auditors this is not in line with the principles of transparency, non-discrimination and equal treatment of suppliers.

Action to be taken/recommendation

Recommendation

In order to increase competition in the tenders in the OP EIC and to prevent single bidding, the MA EIC is requested to ensure that all tender notices are published on the MA EIC website or other suitable website accessible to all potential bidders. This should ensure that all potential bidders can easily search for and participate in these tenders. In addition, there should be a requirement to obtain a minimum number (e.g. three) of offers from contractors that are unrelated to the procuring company.

Importance: Very important

Body responsible: OP EIC managing authority, national coordination body

Deadline for implementation: 2 months

Finding 14

Key requirement: KR 4 - Appropriate management verifications

Inadequate management verifications of procurements as regards conflict of interests

The Commission services noted that finding no 5(b) of the audit authority's system audit no OPPIK/2018/S/001 deals with the inadequate management verifications of public procurements. As explained by the audit authority in the audit report, the MA EIC does not verify the connections between beneficiaries (contracting authority), bidders/suppliers and the bodies, who drafted tender documentation for all procurements.

The Commission services took note that the MA EIC stated in its reply that:

'(...) Moreover, the methodological guideline for the exercise of controls, as well as any other methodological guideline, does not provide an entirely clear list of what the conflict of interest is and what is not. Even if, for example, family ties were identified through ARACHNE or any other similar tool, no methodological guideline sets on how the managing authority should further proceed and the actual family link, with regard to the definition of conflict of interest in order to establish the existence of a conflict of interest, is not enough. (...)

'(...) We require an audit authority to help us to initiate a change to the methodological guideline in question. (...)'.

As per Article 125 of the CPR, the MA EIC is responsible for managing the operational programme. Moreover, under the same article, the MA EIC shall put in place effective and proportionate anti-fraud measures for the operational programme.

Therefore, it is the responsibility of the MA EIC to take appropriate actions as regards the prevention and detection of conflict of interests for procurements linked with the OP EIC and to take appropriate measures to correct and recover ineligible expenditure affected by the conflict of interest in case it is detected. The finding no 12 shows that the MA EIC was not able to make financial corrections for such cases of conflict of interest.

The programme authorities are reminded that they are required to put in place an adequate management and control system in accordance with Article 122 of the CPR. This obligation includes, in accordance with Article 63(1) and (4) read in conjunction with Article 36(3)(c) of the new Financial Regulation, the requirement for those systems to be capable of avoiding conflict of interest. This obligation covers the need to have in place controls systems that ensure their effective and efficient application.

Action to be taken/recommendation

Recommendation 14.01

The MA EIC is requested to take appropriate actions related to the recommendation of the audit authority in the national system audit report no OPPIK/2018/S/001. The Commission services note that the action plan for this finding is still ongoing. Nevertheless, the Commission services emphasise the importance of it being implemented by 30 June 2019 and that the MA EIC verify conflict of interest using ARACHNE or another similar tool, at least on a sample basis.

Recommendation 14.02

The audit authority is recommended to carefully follow-up its recommendation and to verify that improvements in the identification of conflict of interest are in place for OP EIC.Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

5.2.2.3. Findings on the operations

Finding 15

Operation no CZ.01.1.02/0.0/0.0/15_014/0000516 (beneficiary *Pekárna Zelená louka, a.s.*) –ineligible operation

The operation CZ.01.1.02/0.0/0.0/15_014/0000516 (*Innovation line for the production of toast bread*), under objective 1.1, aimed at increasing the technical value and efficiency of technology for the production of toast bread and the properties of new products (removal of preservatives, reduction of salt, extension of shelf life, improvement of taste). The operation outcome presented in the grant application is the **process innovation**, i.e. acquisition of a technology line with significant innovative components (ingredients storage and intakes, vacuum kneading, cleanroom, an innovative production control system) enabling new products, i.e. **three innovative products** to be produced (i.e. three types of toast bread containing wheat yeast). The beneficiary of the operation, *Pekárna Zelená louka, a.s.* is a subsidiary of *Agrofert, a.s.*, a parent company of the AGROFERT group.

In accordance with the Call for operations no 01_15_014 Innovations – can only be supported operations:

- with direct links to Research & Development activities, i.e. they use the results of the own Research & Development, the Research & Development results created during the cooperation or the transfers of technology; and
- for which the Research & Development activities must be completed and demonstrably documented.

From such Research & Development activities the prototype or the sample should have been presented by the applicant/the beneficiary in the grant application.

Part A (Exclusion selection criteria) of the selection criteria for the Call for operations no 01_15_014 Innovations stipulated in point 3 '*Link of the operation to Research & Development activities*' that:

- '*the development has been finalised;*
- '*the operation uses the results of own Research & Development, the Research & Development results created during the cooperation or the transfers of technology;*
- '*in case of own Research & Development or the Research & Development results created during the cooperation the applicant must prove the existence of the functional prototype or the sample;*
- '*in the case of the transfer of technology the applicant must prove the existence of the functional prototype or the sample and this transfer must be contractually supported.*'

However, the real results of the own Research & Development, the Research & Development results created during the cooperation, or the transfers of technology were not presented by the applicant in its grant application.

To prove the Research & Development results created during the cooperation, the applicant submitted:

- a Framework contract for partnership and cooperation in research related to bakery products (signed in February 2015);
- a Treaty on intellectual property rights (signed in March 2015) with The University of Chemistry and Technology Prague (Vysoká škola chemicko-technologická v Praze – ‘VSCHT’); and
- Future planned activities by the university in relation to the toast breads of 24 April 2015 – in the form of a declaration signed only by the university.

None of the documents prove that the cooperation between the applicant and the university took place at the time of the submission of the grant application and that such cooperation was completed. No prototypes / samples from such cooperation were presented by the applicant as requested in the call rules.

Furthermore, the applicant described in the application and presented as a prototype a clean room technology, as the result of the own Research & Development. The applicant presented a pilot line in the bakery in Olomouc as the prototype. In fact, there is no evidence to prove the actual Research & Development, only the selection procedure for the purchase of chilling technology for bread and veils – the cooling spiral for bread and veils and the test minutes from the functioning of the installed technology. The cooling technology is available on the market and is being used by modern bakeries all over the world. Therefore, in the view of the Commission services, the supply of the ‘pilot line’ was a standard purchase of a new technology without any links to the own Research & Development activities. This question was also raised by the selection committee, as shown in point 2 of this finding.

Moreover, the Commission services identified the following observations, which undermine the transparency, equal treatment and the fairness of the selection procedure of the operation in question:

1. Insufficient audit trail and non-compliance with internal procedures in relation to internal evaluators and external experts

- The internal project evaluators were not selected randomly even though this was a requirement the OP manual. Instead, they were assigned in a discretionary manner from a limited number of employees from the unit responsible for the evaluation of the respective call. There was no audit trail to explain how assignments were attributed.
- One internal evaluator was replaced and there is no audit trail for the reasons behind this change.
- The experience and education of both internal evaluators do not correspond to the subject matter of the operation. Based on interviews with the MA EIC’s employees, both evaluators based their opinions on the external evaluations. This is in line with the OP methodology. In case the required expertise goes beyond the professional capacity of an internal evaluator, the evaluator may request an external expert’s opinion as a support for his/her evaluation. However, there is no record that the internal evaluators requested such expertise.
- During the audit mission on the spot, it was not clear how many external experts were

involved in the operation evaluation. The numbers were different depending upon the person interviewed. It was only based on additional information received by email after the mission on the spot, that the number of external evaluators was clarified by the MA EIC.

- One of the external evaluator, external evaluator 1 was replaced by other external evaluator, external expert 2, for not being reliable. From the email correspondence, the auditors identified that external expert 1 only requested a deadline extension until 24 June 2016 because he had not received indicative offers for the budget evaluation. This was not accepted by the MA EIC with comment that such prolongation is not possible. Taking into account that the external evaluator 2 issued his evaluation only on 2 August 2016, the reason for replacement of this expert is not justified.

2. Evaluation and scoring by the evaluators not properly performed and justified

In accordance with the OP Manual - annex D_01_M the evaluation should contain the explanation and number of points awarded. The OP Manual, part D3 stipulates that:

'Internal evaluators for each acceptable grant application that successfully passed a formal evaluation, complete in MS2014+ an assessment form 'the Assessment of the internal evaluator (D3_01_F_assessment of the internal evaluator), the evaluator for each criterion shall set out a clear and comprehensible justification for the outcome of his assessment.

[...]

An external evaluation will be a narrative and will include a reference scoring to be followed by the internal evaluator during the consolidation of the internal assessment. If the internal evaluator does not take over the scoring of an external evaluator or some of his arguments, it shall justify why and explicitly comment on the rejected external evaluator's arguments.'

However, in case of operation CZ.01.1.02/0.0/0.0/15_014/0000516 the evaluators do not sufficiently justify the number of points allocated but limit their comments to either repeating/re-phrasing the text contained in the operation application or simply repeating the selection criteria wording without giving any justification.

In the case of the evaluation of external evaluator 2 the explanations were not provided for part C of the selection criteria relating to *'Necessity and relevance of the project'*. The internal evaluator no 2823, who issued his opinion based on the external evaluator 2's evaluation, only copied the selection criteria wording into his answer. The Selection Committee returned both evaluations of the internal evaluators (see point 3 below) requesting additional clarifications. However, no clarification was provided by the internal evaluator no 2823. However, this evaluation was not rejected by the Selection Committee. This approach of the evaluators, e.g. copying the selection criteria wording, is contrary to the OP Manual.

In some cases, the evaluators refer to a specific document, which does not however justify the number of points allocated. All evaluators gave a maximum number of 5 points for criterion B.2 *'Cooperation with public research institutions or universities in the area of research and development activities in the last 5 years'*. The requirement for such points allocation is the existence of a long-term contract for joint research. A framework contract between the applicant and the VSCHT for partnership and cooperation in research related to bakery products was submitted with the grant application as described above in the finding description. The external evaluator 3 in its evaluation for this criterion provided that: *'Cooperation with VSCHT is evidenced by contracts and documents dating from 2015, which*

cannot be defined as "long-term". Furthermore, in the evaluation for part C the same evaluator explained that: *'The cooperation with research organisations is at an average level and is more in declaratory line than in real research.'* However, regardless of what the external evaluator 3 has said in his comment, he awarded the maximum number of points for this criterion.

In the case of Criterion C3 *'the type of novelty of the resulting product based on Valenta scale'* two evaluators considered that the product (i.e. the toast bread) reached level 5 of innovation on the Valenta scale¹⁶ and two evaluators considered it as level 6:

'Level 6 innovation: New generation, involving a change in all decisive functions of an element of business unit subject to innovation while preserving the original concept of its solution.'

'Level 5 innovation: New variant, representing a change in one or several functions of an element of business unit subject to innovation.'

The Commission services disagree that the product innovation described by the applicant reaches level 5 or 6 of innovation on the Valenta scale. The result of the product innovation described by the applicant does not lead to a new variant or new generation of the product, which would represent a change in one or more of its functions. It is merely a qualitative adaptation of a product already produced by the applicant and his competitors and as such corresponds only to level 4 innovation on the Valenta scale.

In this context, the Commission services also note that the applicant in the first version of the business plan, an attachment to the grant application, states that the product innovation reaches the fifth or the sixth level of innovation. Based on a message sent by the intermediate body through MS 2014+ (*'Interní depeše'*) on 15 January 2016, the applicant was invited to change the level of innovation to level 6 with the comment that: *'the operation can be supported when reaching level 6 of innovation'*. In the new version of the business plan the applicant changed the level of innovation to level 6. Nevertheless, the wording used was not changed and corresponds to level 5. This would have had an impact on the project evaluation.

3. Insufficient audit trail from the meeting of the selection committee

On 26 October 2016, the selection committee returned the operation to the internal evaluators with the following questions:

- What is the exploitation of the results of research and development in the operation?
- How are the Research & Development results in relation to the functional prototype/sample documented?

One of the internal evaluators provided an explanation. However, the issue of the functional prototype was not included in the reply. The second evaluator no 2823 only replied that he insisted on his previous evaluation, which was very brief and did not provide the reply to the two questions.

On 21 December 2016, the selection committee approved the operation. There is no audit trail from the meeting, no explanation why the committee accepted the evaluation of internal evaluator no 2823, only the list of approved operations, including the operation in question.

¹⁶ Valenta, František. (2001). *Inovace v manažerské praxi*. Velryba, Prague.

4. Character of the resulting products not innovative

The Commission services noted that a German company *Lieken AG* has since 2013 also been a member of the AGROFERT group. The Commission services identified that this company produced a toast bread under the brand name Golden Toast, containing wheat yeast, without preservatives, already in 2013. Therefore, when the operation application was submitted to the MA EIC in 2015, the innovative product announced by the company *Pekárna Zelená louka, a.s.* should not have been considered as innovative, as this product was already produced by the AGROFERT group, namely by the company *Lieken AG*.

Under the OP EIC, a model innovation operation under the specific objective 1.1 should consist:

'in introducing new products in the production and placing them on the market and in associated increases in the effectiveness of manufacturing processes and other process innovation (introducing new organisation of business processes, innovating new product development and marketing processes, product certification processes, deployment of new sales channels etc.)'.

In accordance with ECJ case law, an undertaking is defined as a single economic entity having a common source of control. Therefore, as long as the group acts as a single economic unit, it shall be considered as one undertaking. The main prerequisite of the OP, developing a new product, was clearly not the case for the operation in question as the AGROFERT group already produced this product. Therefore, in the opinion of the Commission services the operation should not be supported by the OP EIC.

Therefore, based on the above elements, the Commission auditors consider that the operation was not selected in line with the provisions of Article 125(3) of the CPR and is ineligible.

Action to be taken/recommendation

- a) The managing authority is requested to correct the ineligible expenditure already declared for this operation and to cancel the public contribution to it.
- b) The managing authority is requested to ensure that the evaluation process provides robust evidence to demonstrate full compliance of grant applications with the selection criteria. Operations for which insufficient evidence of compliance is provided in the application should be set aside and a request for further information sent to the applicant. If ultimately they are not in line with the selection criteria they should be rejected.
- c) The managing authority is requested to confirm that the selection criteria were appropriately applied for all remaining operations linked to the AGROFERT group and to apply the necessary additional corrections if needed.

Importance: Critical

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Finding 16

Operation no CZ.01.1.02/0.0/0.0/15_014/0000516 (beneficiary *Pekárna Zelená louka, a.s.*) – error in the calculation of CBA analysis

For the CBA analysis of the operation “*Innovation line for the production of toast bread*”, the risk analyst reviewed only whether the results reported by the applicant seem to be

reasonable. The risk analyst did not review the reality of entries submitted by the applicant in the CBA analysis.

The auditors identified that the amount of total investment included in the CBA analysis, included only the eligible expenditure of 400 mil CZK (approx. EUR 15,5 mio) and not the total operation value of 650 mil CZK (approx.. EUR 25,2 mio) as indicated in the grant application. When recalculating the CBA analysis, the results would be the following:

Total investment	IRR without funding	IRR with funding
CZK 400 000 000	12.76%	18,56%
CZK 650 000 000	4.79%	7,25%

The CBA analysis are filled in by the applicants directly in the MS 2014+. The system automatically shows the results of the CBA analysis. For the IRR below 8%, the system shows that the conclusion should be '*conditions fulfilled with objection*'. The Commission services note that this conclusion would not have had any impact on the substantive evaluation of the operation, as the results of the CBA analysis are not further reflected in the selection criteria. As concluded already by the Commission services during the EPSA mission no REGC414CZ0018, the CBA verification has only a formal character and the correctness of the data is not reviewed. *(Recommendation 04.01. The Czech authorities (MA, IB) should improve the verification of the economic capacity of the applicant/beneficiary. Verification of the CBA should be carried out as requested in the methodology and results of this verification recorded. The comments raised during the economic evaluation should be clearly recorded in the MS 2014+ and used during further stages of the project selection process. Projects where certain financial risks have been identified during the economic evaluation should be closely monitored in this respect during the project implementation and durability period. In addition, for cases where the economic/financial history and capacity is demonstrated via a different entity than the applicant itself, the Czech authorities should request sufficient guarantees from these entities or other sources in order to cover the relevant risks during project implementation and the durability period).*

Action to be taken/recommendation

Importance: Important

The national authorities should set up a system to review the substance of the CBA analysis and the risks identified during this verification should be reflected at the stage of the substantive evaluation of the operations. Moreover, if one element of conclusions from the risk analysis indicates fulfilment with objection, it should be clearly stated in the internal procedures and/or in the selection criteria that this objection triggers rejection of application/return for correction at this stage of evaluation process.

Body responsible: managing authority of the OP EIC

Deadline for implementation: 1 month

Finding 17

Operation no CZ.01.3.10/0.0/0.0/16_061/0011011 (beneficiary: *Ethanol Energy a.s.*) – errors in the calculation of CBA analysis

Category: KR2

Sub-category: Ineligible amount

During the selection of operations the IB (Agency of the Ministry of Industry and Trade – API) carries out checks of formal aspects and eligibility of the project. Two internal evaluators are appointed for this task. One evaluator performs the evaluation and the second one reviews it. In addition, the risk analyst from the IB performs an evaluation under the criterion which relates to economic capacity (section T5A of the Manual and annex D_01_M of the Manual). The evaluation is based on data provided by the applicant in the economic capacity form and submitted as a table annexed to the application. The number of points attributed is not assessed, because it is calculated 'automatically in the table. A minimum number of points of 5 out of 9 can be attributed. The IB verifies only the data entered into the table and it is purely a formal check. After formal and substantial evaluation, the application is transferred to the evaluation committee for final approval.

Even though the project CZ.01.3.10/0.0/0.0/16_061/0011011 (Ethanol Energy a.s.) was evaluated by the risk analyst of the IB "with an objection" and this objection was maintained by the evaluation committee in its decision at a later stage of evaluation process, it was not taken into account by the MA, which signed a grant for co-financing of the project without addressing part of this objection. According to the analyst and the evaluation committee, due to an objection related to a large number of ineligible items included in the budget and the limit of 5% of the project value set for the cost of project documentation being exceeded, the amount of the total budget should be reduced. However, the MA only reduced the total eligible costs related to the ineligible items and did not reduce the amount of the budget dedicated to project documentation (24.189.242,-CZK). As the amount for project documentation represents 5,82% of total eligible expenditure, the difference of 0.82% (CZK 1.968.333,71 / approx. EUR 76.292) is considered ineligible.

Action to be taken/recommendation

Recommendation

The MA is requested to correct ineligible amount of 1.968.333,71 CZK (approx. EUR 76.292) and to cancel the related public contribution to this operation.

Importance: Very Important

Body responsible: Managing Authority OPPI 2007-2013 – Ministry of Industry and Trade

Deadline for implementation: 1 month

Finding 18

Double financing - Non-respect of Article 3(b) of the Regulation (EU) No 1301/2013 - beneficiaries under the EU ETS (Operation no CZ.01.3.10/0.0/0.0/16_061/0011011 (beneficiary: *Ethanol Energy a.s.*) and operation no CZ.01.1.02/0.0/0.0/17_109/0011122 (beneficiary *Lovochemie a.s.*))

Category: KR2

Sub-category: Ineligible project There is a following requirement under *Article 3 of the Regulation (EU) 1301/2013 - Scope of support from the ERDF [...]*

3. The ERDF shall not support:

(b) investment to achieve the reduction of greenhouse gas emissions from activities listed in Annex I to Directive 2003/87/EC.

REGIO provided, the guidelines (letter of 29/06/2016 (Ares(2016)3071251) and emails of 03/10/2016 (EU) and 27/11/2016 (AVB) which included a detailed interpretation from the Commission and required carrying out individual assessment of the applications submitted by the beneficiaries subject of the EU ETS scheme.

Under the call nr II – dedicated to energy savings, the rules for the selection of operations included provisions that required individual assessment of the project application if the applicant is part of the European Emissions Trading System (EU ETS). The applicant was requested to briefly describe why the project activities were not concerned by the activities included in Annex I of Directive 2003/87/EC of the European Parliament and of the Council (Directive establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, hereinafter referred to as “Annex I”). This description was to include:

- Energy efficiency improvement measures supported under the project and its relation to the main production systems identified among the Annex I activities.
- The amount of allowances under the EU ETS scheme to be reported on an annual basis.
- The quantity of emissions reported and the impact of project implementation on its level.

REGIO auditors did not identify any individual written assessments as part of the project application where the applicant was part of the EU ETS (link to national register of companies benefiting of the EU ETS: https://www.mzp.cz/cz/seznam_zarizeni_euets). The scope of the project was not assessed against the scope of the greenhouse gas emission certificate issued at national level and the conclusions have not been drawn by the managing authority. Under the call nr II one operation is concerned namely, Ethanol Energy a.s. (CZ.01.3.1.0/0.0/0.0/16_061/0011011). It relates to replacement, complement and modification of technological processes and technology in manufacturing for hydrolysis, and distillation that is part of the installation used for producing different chemical components by the beneficiary. This installation is fully dependant on the heat source – coal boilers (3 x15,9 = in total 47,85MW). The investment is presented as one which aims at a reduction in CO2 emissions of 23.293t/year. Under specific substantive selection criterion requiring a reduction in CO2 emissions, the application was evaluated and was given maximum points (32). Therefore, REGIO auditors concluded that that the beneficiary benefited from the support of both the ERDF and the EU ETS scheme, therefor the operation is considered ineligible as the Article 3 (3)(b) of the Regulation (EU) No 1301/2013 was not respected.

No information on the fact that the applicant/beneficiary is part of the EU ETS scheme was included in the project application, feasibility study, energy opinion or business plan. In addition, during the assessment of the application the evaluators did not refer to the requirements of the call II rules ((9.3 1)k); 9.3 2)a)b) – *“the applicant shall confirm in the feasibility study the compliance of the proposed project with these specific conditions (Article 3(b) of Regulation (EU) No 1301/2013 the European Regional Development Fund (ERDF Regulation) and on specific provisions concerning the Investment for growth and jobs goal for project admissibility”* and they did not make any written statement in the evaluation of the application file.,

Under the call nr IV – dedicated to enhancing innovation performance of enterprises, projects related to increasing efficiency of energy use or reducing the energy consumption of the applicant shall not be supported. At the same time, the project shall not violate the

sustainable development principle defined in the Article 8 of the CPR and it shall comply with the EU and Czech environmental legislation (exclusion criterion no 5 of that call).

In the case of the application from Lovochemie a.s. (CZ.01.1.02/0.0/0.0/17_109/0011122), an individual assessment by the managing authority/intermediate body did not take place as far as the scope of the project is concerned against the scope of the greenhouse gas emission certificate issued at national level.

This application for co-financing relates to the introduction of an innovative solution to produce a mix of ammonium sulphate, which is the essential raw material for the production of sulphur fertilisers. However, it is expected by the applicant that as a result of the project, a significant reduction of emissions from the production of DASA — NO_x, dust, NH₃ will be achieved as well as electricity cost savings. The managing authority / intermediate body did not carry out an assessment of the greenhouse gas emission permit issued at national level in order to exclude potential double financing as required by Article 3 (3)(b) of the ERDF Regulation no 1301/2013.

At the request of REGIO auditors the managing authority explained that compliance of the project application was reviewed and the conclusion issued confirmed compliance with the Article 3 (3)(b) of the ERDF Regulation. However, REGIO auditors could not identify any separate document issued during the evaluation of the applications to support this conclusion. Moreover, the applications submitted in both cases did not refer to the fact that both beneficiaries are part of the EU ETS scheme monitored by national authorities and no analysis of the relevance of the content of the green certificates issued and project application were carried out.

In case the MA intends to support beneficiaries of the EU ETS scheme **not listed in Annex I to Directive 2003/87/EC may be considered eligible**. Reduction of GHG shall not be a direct effect of the operation support and shall not increase the output capacity of the facility supported when the EU ETS scheme operator applies for the ESIF support.

Therefore, both operations are considered ineligible in their entirety.

Action to be taken/recommendation

Recommendation

- a. The managing authority is requested to correct the ineligible expenditure and to cancel the public contribution to the operations Ethanol Energy a.s. (CZ.01.3.1.0/0.0/0.0/16_061/0011011) and Lovochemie a.s. (CZ.01.1.02/0.0/0.0/17_109/0011122) and to provide details to the Commission.
- b. The managing authority is requested to verify all other operations under the EU ETS scheme to ensure that there is no double financing.

Importance: Critical

Managing authority – Ministry of Industry and Trade

Deadline for implementation: 1 month

Finding 19

Ineligible operation 2014-2020 - Project no CZ.01.1.02/0.0/0.0/17_109/0011122 (beneficiary Lovochemie a.s.) –

Category: KR2

Sub-category:

Contrary to the obligation set out in the Evaluation Model for Call IV “Innovation”, the evaluators do not sufficiently “*justify in their own words*” [sic] the amount of points allocated but limit their comments to either repeating/rephrasing the text contained in the project application. In some cases, the evaluators refer to a specific document, which however, does not justify the amount of points allocated or provide a general statement referring to “*documents provided by the applicant*” which hinders the re-performance of the evaluation process.

REGIO auditors identified the following errors in the evaluation process, which had an impact on the amount of points attributed to the applicant:

- For criterion B.1 (“Technology transfers taking place in the last 3 years in the form of exploitation of intellectual property rights (invention/patent, industrial or utility model)”, the evaluator no 2826 gave 2 out of the maximum 2 points and justified this point allocation by a general statement saying that “*the applicant proved the technology transfer (patent, know-how) by supplying the necessary documents*” but fails to identify the specific document based on which he reached his conclusion. For the same criterion, the evaluator no. 4252 allocated 1 out of 2 points and justified this points allocation by stating that “*the applicant carried out 1 relevant technology transfer in the form of transfer of patent for granular fertilizer (Dusíkaté sirné granulové hnojivo a jeho příprava) from VUCHT a.s. to the applicant.*”

However, this agreement does not qualify as an agreement demonstrating the transfer of intellectual property rights to a patent because the subject matter of the agreement was not protected by a patent and as such cannot serve as a justification for the points allocation.

Moreover, even if a transfer of intellectual property rights took place between VUCHT and the applicant, such a transfer should be considered as an internal transfer within the same group as both companies are part of AGROFERT group.

- Both evaluators (no. 4252 and no. 2826) gave 4 points out of the maximum 4 points for criterion B.2 ‘*Cooperation with public research institutions or universities in the area of research and development activities in the last 5 years*’. The requirement for such a points allocation is the existence of a long-term contract for joint research. In order to justify the 4 points, the evaluator no. 4252 refers to a long-term cooperation of the applicant with ÚJV Řež, a.s. (a commercial company outside of the AGROFERT group). Given the fact that ÚJV Řež is not a public research institution nor a university, such cooperation cannot serve as a justification for allocating the 4 points by evaluator no. 4252. The second evaluator justified the points allocated only by stating that “*the applicant supplied relevant documents demonstrating a cooperation with universities and public research institutions*” but did not refer to a specific agreement which in his opinion fulfils the set requirements.
- For criterion B6 „*Own research and development department or innovation strategy of the company*“, both evaluators gave 2 out of the maximum 2 points and justified their allocation by referring to applicants „*research and innovation department which*

creates his research and development strategy". In addition, the evaluator no. 4252 states that the existence of this department is proved by the organisational structure of the applicant. REGIO auditors detected in this context that the applicant does not have a research and development department. On the contrary, the applicant's annual reports explicitly states that *'the department of technical development was cancelled in 2012 and the research activities are dealt with centrally by Agrofert a.s.'* As the applicant does not have a research and development department and does not describe its innovation strategy, the allocation of points cannot be considered justified.

- In the case of criterion C3 for which both evaluators allocated 4 points corresponding to Level 5 product innovation on the Valenta scale, the evaluators only repeat/rephrase statements provided by the applicant in its business plan / feasibility study without providing their own independent assessment of why a specific number of points was allocated. In this context, REGIO auditors assessed the product innovation described by the applicant and came to the conclusion that it does not reach Level 5 innovation on the Valenta scale. The result of the product innovation described by the applicant does not lead to a new variant of the product which would represent a change in one or more of its functions but is merely a qualitative adaptation of a product already produced by the applicant and his competitor and as such corresponds only to Level 4 innovation on the Valenta scale. Thus, no points should have been allocated for this criterion.

Despite the errors in the evaluation described above and insufficient justification provided by the evaluators, the selection committee recommended the project for financing without requesting the evaluators to comply with their obligation set out in the Evaluation Model. Given the fact the project was not evaluated in line with the Evaluation Model, it should not have been recommended for financing by the selection committee and as a consequence is not considered eligible for financing.

Action to be taken/recommendation

Recommendation

- d) The managing authority is requested to correct the ineligible expenditure already declared for this operation and to cancel the public contribution to it.
- e) The managing authority is requested to ensure that the evaluation process provides robust evidence to demonstrate full compliance of grant applications with the selection criteria. Operations for which insufficient evidence of compliance is provided in the application should be set aside and a request for further information sent to the applicant. If ultimately they are not in line with the selection criteria they should be rejected.
- f) The managing authority is requested to confirm that the selection criteria were appropriately applied for all remaining operations linked to the AGROFERT group and to apply the necessary additional corrections if needed.

Importance: Critical

Managing Authority OP PIK 2014-2020 – Ministry of Industry and Trade

Deadline for implementation: 1 month

5.2.3. Enterprise and Innovation OP (CCI 2007CZ161PO004) 2007 - 2013

Finding 20

Ineligible operation - Project no IN04/644 (beneficiary *Lovochemie a.s.*) –

The operation IN04/644 (Complex process innovation) aimed at innovation of the production process for nitrogen compounds, namely the improvement of the production process of calcium nitrate (process innovation) and quality improvements of two variants of this product. The project outcome presented in the grant application is:

- Process innovation (improvement of the production process of calcium nitrate)
- Product innovation (quality improvement of Agri Grade (AG) and Greenhouse Grade (GG) variant of calcium nitrate)

The beneficiary of the project, *Lovochemie, a.s.* is a subsidiary of *Agrofert, a.s.*, a parent company of the AGROFERT group.

In accordance with the Call for projects no IV Innovations – only operations with direct links to Research & Development activities (i.e. they use the results of their own Research & Development, the Research & Development results created in cooperation or the transfers of technology) can be supported.

Part I (Exclusion selection criteria) of the selection criteria stipulated in point 2 '*Link of the project to Research & Development activities*' that:

- '*the development has been completed;*
- '*the project uses the results of own Research & Development, the Research & Development results created in cooperation or the transfers of technology;*
- '*in case of own Research & Development or the Research & Development results created during the cooperation, the applicant must prove the existence of the functional prototype or the sample;*
- '*in the case of the transfer of technology the applicant must prove the existence of the functional prototype or the sample and this transfer must be supported by a contract.*'

In reply to this exclusion criterion, the applicant states that the project relies on the results of research and development activities of VUCHT, a.s. (a company belonging to the AGROFERT Group). The research results of VUCHT led to a patented method of preparation of granulated water-soluble calcium-nitrogen fertilizer (patent no. 287816, which contains a detailed description of the production process of calcium nitrate). This patent is owned by company Duslo, a.s. (a company belonging to the AGROFERT Group).

In order to demonstrate the existence of a functional prototype and product samples, the applicant stated that company Hnojivá Duslo s.r.o. (another company belonging to the AGROFERT Group) possessed a functional production line and samples because the company is already producing these products.

Given the fact, that another company in the AGROFERT Group already possessed the production line which was subject of the innovation described in the project application (process innovation) and was already producing the products subject of the innovation described in the project application (product innovation), REGIO auditors take the view that the project does not introduce any innovation supported by the existence of a prototype or a sample. Therefore the binary selection criteria were not met and the project application should have been excluded from further evaluation as ineligible.

Moreover, the Commission services identified the following observations, which undermine the transparency, equal treatment and the fairness of the selection procedure of the project in question:

Insufficient audit trail related to external evaluators selected for the substantive evaluation of a project

For the preparation of the REGIO's audit, the Czech authorities provided two evaluation sheets prepared by external evaluators selected for substantive evaluation of a project application. Both of these external evaluators recommended the project for financing. One evaluator allocated 45 points and the other 46 points out of 81 (the minimum amount of points necessary for approving the project was 45 points).

During the audit, the auditors received a list of external evaluators selected for evaluating project applications submitted in reply to the Call in question. This list mentions that three external evaluators were actually used for evaluating this operation. In contradiction to the documents provided before the mission and the information contained on the list of external evaluators, REGIO auditors found four evaluation sheets when reviewing the project related documentation in the ISOP IT system. As only two out of these four evaluation sheets were in a format that REGIO auditors were able to open, the auditors requested the MA to provide all four listed evaluation sheets in a PDF format. Following the receipt of the PDF documents, REGIO auditors found three evaluation sheets allocating between 45 and 46 points recommending the project for financing and one evaluation sheet with 41 points and not recommending the project for financing.

While on the basis of the documents presented before the audit mission, REGIO auditors understood there were only two evaluation sheets related to this project, the list of evaluators presented during the mission mentioned three evaluators and REGIO auditors finally identified four evaluation sheets actually dealing with this project evaluation. No information was presented to REGIO auditor clarifying the discrepancy of the information provided before, during and after the mission and explaining when and why the individual evaluators were replaced and on the basis of what considerations, two out of the four evaluation sheets were selected to be taken into account when recommending the project for financing.

In this context, the managing authority is requested to explain the sequence of events, and provide clarification as to why and when the additional evaluators were invited to evaluate the project application.

Errors in the evaluation process

REGIO auditors identified errors in the evaluation process, which had an impact on the amount of points attributed to the applicant.

- For criterion A.2 (*“Technology transfers taking place in the last 3 years in the form of exploitation of patent or purchase/sale of license”*), two out of the four evaluators allocated 2 out of 2 points, one evaluator allocated 1 point and one allocated 0 points. REGIO auditors did not identify any technology transfer either referenced in the applicant's feasibility study or provided in any of the submitted annexes. Thus, in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion A.3 (*“Cooperation with R&D institutions or universities in the last three years”*), two points can be allocated when the applicant presents a long-term contract for joint research. All four evaluators allocated 2 out of 2 points referring to a contract concluded with University of Chemistry and Technology Prague (Vysoká škola chemicko-technologická v Praze – ‘VSCHT’). REGIO auditors did not identify in the project file any contract with VSCHT which would qualify as *“a long-term contract for joint research”* and thus in the REGIO auditors view, the two points should not have been given.
- For criterion A.8 (*“Own research and development department or innovation strategy of the company”*), three evaluators allocated 2 out of maximum 2 points and one evaluator allocated 0 points. The applicant mentions in its feasibility study a “Department of development and quality” but which cannot be considered a research and development department. Given the fact that the applicant does not have a research and development department and does not describe its innovation strategy, in the REGIO auditors view, no points should have been allocated for this criterion.
- For criterion B.1 (*“How is the project reacting to the market situation”*), two evaluators allocated 4 points, one evaluator 3 and one evaluator 2 out of six points. While the project application introduces a product of improved quality, the applicant himself states that these products are already produced by DUSLO s.r.o. which is a company belonging to the AGROFERT Group and is listed in its consolidated annual reports. From this perspective, the applicant only extends the production which already underway at DUSLO in Slovakia to the Czech Republic. In the REGIO auditors view, one point could be considered for maintaining the market share of the applicant.
- For criterion C.1 (*“What is the novelty type of the process from the point of view of the technical solution”*), three evaluators allocated 3 and one 6 out of maximum 6 points. Given the fact that the process had already been implemented by DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there is no novelty introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.
- For criterion C.2 (*“What is the novelty type of the process from the point of view of the market”*). All 4 evaluators allocated 3 out of 6 points for this criterion. Given the fact that the process was already in use in DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there innovation introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.
- For criterion C.3 (*“What is the novelty type of the resulting product from the point of view of the technical solution”*), Two evaluators allocated 3, one evaluator 4.5 and one 6 out of the maximum of 6 points. Given the fact that the products were already produced by DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there is no product innovation introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.
- For criterion C.4 (*“What is the novelty type of the resulting product from the point of view of the market”*), all four evaluators allocated 4 out of 8 points for this criterion. Given the fact that the products were already produced by DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there is no product innovation introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion D.1 (*“Exploitation of results of R&D in the project”*), three evaluators allocated 5 and one evaluator allocated 3 out of maximum of 5 points. Given the fact that the applicant cannot demonstrate the existence of a functioning prototype/or a sample and on the contrary confirms that the technology based on the research of VUCHT had been already implemented in DUSLO s.r.o., in the REGIO auditors view, no points should have been allocated for this criterion.

Given the fact the project did not meet the binary selection criteria and also taking into account additional errors detected in the substantive evaluation and audit trail, the REGIO auditors take the view that the project should not have been selected for financing and is considered ineligible.

Recommendation

The MA is requested to correct all related ineligible expenditure already declared under the operational programme – since the operational programme is already closed, the Member state is requested to reimburse this amount the European Commission.

Importance: Critical

Managing Authority OPPI 2007-2013 – Ministry of Industry and Trade

Deadline for implementation: 1 month

5.3. ESF Findings and actions to be taken / recommendations

5.3.1. Employment OP (CCI 2014CZ05M9OP001)

5.3.1.1. Findings on operations

Finding 21

Project No: CZ.03.1.52/0.0/0.0/16_043/0004636

Beneficiary: Synthesia, a.s.

Inadequate verification of the ownership structure and conflict of interests

The Commission services noted that the obligation for disclosing the ownership structure up to the level of the beneficial owner is applied for all calls for projects launched after 1/9/2016. Consequently, in the project application the applicant/beneficiary has to specify the beneficial owner(s) in the form of a declaration of honour. Moreover, the applicant/beneficiary is obliged to provide further supporting documents as regards their beneficial owners upon request of the MA. Finally, all changes in the ownership structure should be reported to the MA without delays.

The Call for project No 16_043 was published on 15/6/2016. At that time, no obligation for the applicant existed to submit its ownership structure with the application. However, as per Article 59(1) read in conjunction with Article 32(3) of the Financial Regulation 2012 the management and control system should avoid conflict of interests situations. Although no definition of conflict of interests is available for shared management, Article 57 of the Financial Regulation 202 provides the elements and criteria under which a conflict of interests should be considered as present.

The grant agreement with the beneficiary (who is part of the AGROFERT group) was awarded on 1/3/2017. On 24/3/2017, the beneficiary informed the MA that there was a change of the ownership structure of the beneficiary as since 3/2/2017 the owners of the beneficiary *Synthesia, a.s.* became two trustees of the Trust Funds established by Mr Babiš.

The Commission services have the following observations:

- The project application was sent to the MA in August 2016, i.e. in the period when Mr Babiš served as Minister for Finance and Deputy Prime Minister for Economy and simultaneously was 100% sole shareholder of the AGROFERT group. Although the project application was thus sent before its entry into force of the modifications of the Czech Act N° 159/2006 Coll. on conflict of interest, the project was awarded after this entry into force. It is unclear to the Commission services which checks the Managing Authority applied to verify compliance of the grant request with the modified act and on the basis of which criteria it determined that the grant could be awarded.
- As explained under the finding No 1, the beneficial owner in the case of trusts is the settlor, the trustee, the protector or the beneficiary. It means that Mr Babiš is also the beneficial owner of the Trust Funds. In order to avoid conflict of interests, the Commission services consider that this information should have been identified by the MA during the selection process. However, the Managing Authority did not inform us, to date, on the actual checks it performed to verify the structure of the Trust and its compliance with Czech national law.

Action to be taken/recommendation

Recommendation

The MA is recommended to strengthen the review of the ownership structure up to the level of the ultimate beneficial owner, in particular in the case of trusts. Moreover, the MA needs to distinguish between the notion of *business activity* and the *administration of a person's assets* when reviewing a conflict of interests, specifically Article 4(1) and (2) of the Czech Act No 159/2006 Coll. on conflict of interests.

Importance: Very important

Body responsible: MA

Deadline for implementation: 2 months

Finding 22

Project No: CZ.03.1.52/0.0/0.0/16_043/0004636

Beneficiary: Synthesia, a.s.

The objective of the Call for projects No 03_16_043 published on 15/6/2016 was to provide trainings to employees of companies. Standard scales of unit costs for the training of employees were used. The selection of projects included the evaluation of objective information about the applicant, e.g. size of the business, business address and the types of trainings with a maximum number of 100 points to be awarded. As regards the evaluation of the size of the applicant, the Commission services noted that according to the award criteria a small enterprise receives 20 points, a medium enterprise 10 points and a large enterprise 0 points. This suggests that the intention of the MA was to provide EU support mainly to small and medium sized enterprises.

In case a project involved partners, the number of points awarded to an application was a simple average of points given to a particular participants (i.e. applicant and partners). This led to situations where large enterprises, acting as applicants, involved in their projects several small or medium sized partners in order to receive more points for "*the size criterion*". However, the fact whether these partners participated substantially in the projects (i.e. whether the employees of these companies were trained) and what was the extent of their participation was not subject to the evaluation of the MA.

The project No CZ.03.1.52/0.0/0.0/16_043/0004636 of the beneficiary *Synthesia, a.s.* (a large enterprise) included a partner company *Zámečnictví Šejvl s.r.o.* (a small enterprise). The estimated extent of the training for these two companies was as follows:

Subject	Total value of the trainings to be provided to the employees	
Synthesia, a.s.	CZK 1,889,280 (€75,571 ¹⁷)	99.47%
Zámečnictví Šejvl s.r.o.	CZK 10,080 (€403 ⁵)	0.53%
Total	CZK 1,899,360 (€75,974 ⁵)	

¹⁷ Exchange rate of 25 CZK/€

The project received 10 points for the criterion "*size of the applicant*" for involving a small enterprise as a partner, even though this partner participated in the project only to a very small extent (0.53%). The auditors acknowledge that *Synthesia a.s.* would have received the grant even if the partner had not been involved.

The Commission services acknowledge that for future calls on training of employees the MA considered that projects of large enterprises will not be allowed to involve partners or partnerships will not be allowed at all. In fact, for the Call No 97 published on 15/3/2019 the MA decided to remove "*the size criterion*" from the selection criteria altogether, i.e. applications involving small and medium enterprises are no longer favoured.

Action to be taken/recommendation

Recommendation

The MA is recommended when designing the calls for projects that would give a priority to small and medium sized enterprises to ensure that the involvement of small and medium sized enterprises is substantial.

Importance: Important

Body responsible: MA

Deadline for implementation: 3 months

6. AUDIT CONCLUSIONS AND OPINION

6.2. AUDIT CONCLUSIONS

The objectives of the audit mission were:

Audit objective 1

In relation to the grants signed with companies of the AGROFERT group between June 2011 and July 2018, obtain reasonable assurance that the management and control systems covering the above-mentioned programmes before the entry into force of Financial Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union were compliant with the regulatory framework and functioned effectively regarding the allocation of EU funds, from the approval of the programmes to the implementation phase, focusing specifically to measures in place to avoid conflict of interests;

Audit objective 2

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 2 - Adequate selection of operations as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods¹⁸;

Audit objective 3

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 4 – Adequate management verifications as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods¹⁹;

Audit objective 4

To establish whether there is evidence of conflict of interest in the process of allocating EU funds to programmes or sectors that could favour operations introduced by companies of the AGROFERT group; and

Audit objective 5

To identify and assess changes in the structures, staffing and working procedure of the competent national authorities including the selection committees that might have influenced the attribution processes or the national controls and audits.

6.2.1. ERDF / CF Funds

Based on the work carried out as indicated in chapter 3 of this report and without prejudice to further audit work from our services, the auditors draw conclusions on the operations for which companies from the AGROFERT group were beneficiaries based on the representative sample audited.

¹⁸ Articles 58-60 of EC Regulation (EU) N° 1083/2006 (in the 2007-2013 programming period) and Articles 72-74 and 123-125 of Regulation (EU) N° 1303/2013 (in the 2014-2020 programming period).

¹⁹ See footnote 18.

For REGIO, the sample consisted of 36 operations selected from the 98 operations of the AGROFERT Group companies co-financed by the ERDF/CF from 2012 to 2018. Such a large sample ensured high coverage of both managing authorities and both programming periods.

The sample audited gave the following coverage:

Prog. Period	MA	Value sample (EU contribution) In CZK	Value population (EU contribution) In CZK	%	Number of operations in sample	Number of operations in the population	%
2007-2013	MoIT	291.344.453,00	416.025.203,00	70%	11	22	50%
2007-2013	MoE	684.273.007,0	799.839.868,45	86%	13	52	25%
2014-2020	MoIT	243.622.416,18	340.519.464,91	72%	10	22	45%
2014-2020	MoE	86.865.838,30	86.865.838,30	100%	2	2	100%
Totals		1.306.105.714	1.643.250.374,7	79%	36	98	36%
		EUR 50.624.252	EUR 63.691.875				

The conclusions of the auditors are set in the table below, per audit objective:

<u>Audit objective</u>	<u>2007-2013 period</u>		<u>2014-2020 period</u>	
	OP Enterprise	OP Environment	OP Enterprise	OP Environment
Operations audited	11 out of 22	13 out of 52	10 out of 22	2 out of 2
Operations considered ineligible:				
• Sample errors with only a random element	1	0	1	0
• Sample errors with only a systemic element ²⁰	0	0	0	2
• Sample errors with a random and a systemic ²¹ element	0	0	7	0

²⁰ These two systemic errors are not included in the calculation of the projected error rate of 18.48%, which is based on the 9 operations affected by random errors only (see Annex II.a for the list of these 9 operations).

²¹ In addition to the sample errors there are 7 other operations outside the audit sample which are affected by the same systemic error.

Objective 1 (MCS for COI)	Cat. 3 ²²		Cat. 3
Objective 2 (KR 2)	Cat. 3	Cat. 2	Cat. 3
Objective 3 (KR 4)	Cat. 3		Cat. 3
Objective 4 (Allocation of funds)	Cat. 3		
Objective 5 (Changes)	Cat. 2		

KR16 (Adequate audits of operations) is assessed in category 2 (works, some improvements are needed) and no evidence of undue influence on the work of the audit authority was identified.

Based on the audit work carried out, the following conclusions can be drawn with regard to the effective functioning of the management and control system and with regard to the legality and regularity of individual operations audited:

A. Multiple random errors detected in the sample of operations audited indicating serious deficiencies in the functioning of the management and control systems

From the sample of 36 operations from the population of 98 operations, the auditors detected 9 errors representing a random projected error rate in the population of 18.48%.

The list of these random errors is provided at Annex II.a.

This high error rate, combined with the frequency and nature of the errors identified demonstrate the existence of serious deficiencies in the functioning of the management and control system, in particular in relation to the effective functioning of KR2 (selection) and KR4 (management verifications) and justify a Category 3 assessment of the systems for both periods 2007-2013 and 2014-2020.

Both programming periods are concerned and all the managing authorities, except for the MA Ministry of Environment for the programming period 2007-2013.

Therefore, a financial correction of 18,48% should be applied to the entire population.

The extrapolated correction amounts to 303.681.873,62 CZK (approx. EUR 11,77 mio). This includes the individual corrections amounting to 285.226.785 CZK (approx. EUR 11,06 mio) for the 9 individual operations.

²² Category 3 – Works partially; substantial improvement(s) are needed; Serious deficiencies were found that expose the Funds to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant.

B. Systemic errors related to the breach of conflict of interests issues

B.1 As regards the period before 9 February 2017

For ERDF/CF, from the population of 98 operations, the grant agreements for 82 of them were signed during the period before 9 February 2017, totalling 1.360.530.878 CZK (approx. EUR 52,73 mio).

For this period, the Commission services conclude that Mr Babiš was engaged in business activity and the Czech authorities did not ensure that the management and control systems in place avoid situations of conflict of interests. In this regard, there was no evidence that any action has been taken at national level in respect of this non-compliance, which represents an additional deficiency in the MCS. They thus did not comply with Article 32 (3) of Regulation 966/2012 and Article 4(1) of the Czech Act No 159/2006.

However, the Commission services understand that Czech national law on conflict of interest did not prohibit granting of public funds, including EU funds, to companies in which the public official was involved.

Therefore, no financial corrections are proposed by the Commission in respect of this breach of national rules or Article 32 (3) of Regulation 966/2012.

B.2 For the period after 9 February 2017

For the ERDF/CF, from the population of 98 operations, the grant agreements for 16 of them were signed during the period after 9 February 2017, for a total of 282.719.496 CZK (approx. EUR 10,96 mio).

The list of these 16 grants is provided at Annex II.b.

For this period, the Commission services conclude that, in addition to the Czech authorities' continued non-compliance with Article 32 (3) of Regulation 966/2012 and as of 2 August 2018, Article 36 (3) of Regulation 1046/2018 and Article 4(1) of the Czech act, 16 grants awarded to AGROFERT group companies after that date did not comply with Article 4c of the Act No 159/2006 and are therefore irregular and a 100% financial correction should be applied to all related expenditure already declared to the Commission for these operations (see Annex II.b.) and the public contribution to them should be cancelled. This represents 16 operations (all from the 2014-2020 period, 14 for EI OP and 2 for ENV OP). The total EU contribution amount affected is CZK 282.719.496 (approx EUR 10,96 mio). However, as 7 of these 16 operations, with a public contribution of EUR 5.24 mio, are already being corrected under point A, they do not need to be corrected again. This leaves a net amount of EUR 5.72 mio to be corrected under this point.

C. Total corrections required

The total amount of corrections proposed (stemming from both the extrapolated sample errors and the systemic irregularities at points A and B.2 amounts to CZK 451.174.585 (approx. EUR 17,49 mio) representing 27,46% of the EU contribution.

This correction is calculated as follows:

<u>Point</u>	<u>Correction</u>	<u>Value in EUR mio</u>
A	Random errors projected to the entire population (98 operations)	11,77
B.2	+ Value of the 16 systemic errors	+10,96
B.2	- Value of the 7 systemic errors already included as random errors	-5,24
	= Total correction	17,49

AUDIT OPINION

Qualified opinion: Based on the work carried out as indicated in chapter 3 of this report, the auditors have obtained reasonable assurance that the management and control systems, put in place at the level of the audited bodies, including the audit authority (see section 3 of the report) with regard the audit objectives 1 to 5 mentioned above, work effectively, except for:

- Audit objective 1, for the programming periods 2007-2013 and 2014-2020, for all MA and IB under review;
- Audit objective 2, for the programming periods 2007-2013 and 2014-2020, for all MA and IB under review, excluding the Ministry of Environment – 2007-2013 period and
- Audit objective 3, for the programming periods 2007-2013 and 2014-2020, for all MA and IB under review, excluding the Ministry of Environment – 2007-2013 period.
- Audit objective 4, for the programming periods 2007-2013 and 2014-2020.

where the qualification is significant (systems work partially, substantial improvements are needed - category 3).

The above opinion is based on the evidence gathered in the context of our audit concerning the scope defined above.

The national authorities should:

- Apply an 18,48% correction to the expenditure declared to the Commission in respect of all 98 operations in the population, based on the projected error rate resulting from the errors identified in the representative sample audited. Alternatively, re-verify all grants awarded and implement financial corrections for any irregular operations identified stemming from the re-verification exercise.

- b. Apply a 100% financial correction in respect of all expenditure declared for the 16 operations identified as being in breach of Article 4c of Act No 159/2006 and cancel the public contribution for these operations;
- c. Verify all grants awarded on or after 9 February 2017 for all concerned 2014-2020 operational programmes (i.e. the Environment OP and the Enterprise and Innovation for Competitiveness OP) to ensure that they were awarded in compliance with Article 4c of Act No 159/2006 and from 2 August 2018, Article 61 of the Financial Regulation 2018, as concerns possible conflict of interests situations that may have affected grants awarded to any beneficiary. Financial corrections and cancellation of the related public contribution should be implemented for any irregular operations identified by this verification.
- d. In line with the obligation under Article 36 (3) of Regulation (EU, Euratom) 1046/2018, improve the management and control systems in place to identify any cases of non-compliance with Article 4 (1) and 4c of Act No 159/2006 or Article 61 of the Financial Regulation 2018 to ensure that no further grants are awarded in breach the rules on conflict of interests.
- e. Advise of any actions taken or proposed to be taken for the non-compliance of Mr Babiš with Articles 4(1) and 4(c) of Act No 159/2006.

6.2.2. ESF

Based on the work carried out as indicated in chapter 3 of this report and without prejudice to further audit work from our services, the auditors draw conclusions on the operations for which companies from AGROFERT group were beneficiaries

For EMPL, the auditors audited all ESF operations (3 operations) granted to the AGROFERT group companies co-financed by the ESF from 2012 to 2018.

The conclusions of the auditors are set in the table below, per audit objective:

Objective	2007-2013 period		2014-2020 period
	OP Human Resources and Employment	OP Prague - Adaptability	OP Employment
Objective 1	n/a*	n/a*	Cat. 3 ²³
Objective 2	n/a*	n/a*	Cat. 3 ¹⁰

²³ *Category 3 - Works partially; substantial improvement(s) are needed.* Serious deficiencies were found that expose the Funds to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant

Objective 3	Cat. 2 ²⁴	n/a*	n/a**
Objective 4	Cat. 3 ¹⁰		
Objective 5	Cat. 2 ¹¹		

** Both ESF projects audited for the programming period 2007-2013 were awarded before the participation of Mr Babiš in the Government. Moreover, the operation from the OP Prague – Adaptability was financially closed before the beneficiary was acquired by the AGROFERT group.*

*** No expenditure declared to the Commission*

Based on the audit work carried out, the following conclusions can be drawn with regard to the effective functioning of the management and control system and with regard to the legality and regularity of individual operations audited:

B. Systemic errors related to the breach of conflict of interests issues

B.1 As regards the period before 9 February 2017

For ESF, 2 grants awarded during this period, with the total amount of 4.775.087 CZK (approx. EUR 185.081).

For this period before 9 February 2017 the Commission services conclude that Mr Babiš was engaged in business activity and the Czech authorities did not ensure that the management and control systems in place avoid situations of conflict of interests. In this regard, there was no evidence that any action has been taken at national level in respect of this non-compliance, which represents an additional deficiency in the MCS. They thus did not comply with Article 32 (3) of Regulation 966/2012 and Article 4(1) of the Czech Act No 159/2006.

However, the Commission services understand that Czech national law on conflict of interest did not prohibit granting of public funds, including EU funds, to companies in which the public official was involved.

Therefore, no financial corrections are proposed by the Commission in respect of this breach of national rules or Article 32 (3) of Regulation 966/2012.

B.2 For the period after 9 February 2017

For ESF, 1 grant was awarded during this period, with the total amount of 1.899.360 CZK (approx. EUR 73.619).

For this period after 9 February 2017 the Commission services conclude that, in addition to the Czech authorities' continued non-compliance with Article 32 (3) of Regulation 966/2012 and as of 2 August 2018, Article 36 (3) of Regulation 1046/2018 and Article 4(1) of the Czech act 1 ESF grant awarded to an AGROFERT group company after that date did not comply with Article 4(c) of the Act No 159/2006 involving a total EU contribution amounting to CZK 949.680 (approx. EUR 36.809). No expenditure has been declared to the

²⁴ *Category 2. Works, but some improvement(s) are needed.* Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the assessed key requirements / authorities / system. Recommendations have been formulated for implementation by the audited body.

Commission. Therefore, the cancellation of public contribution should be applied by the managing authority.

AUDIT OPINION

Qualified opinion: Based on the work carried out as indicated in chapter 3 of this report, the auditors have obtained reasonable assurance that the management and control systems put in place at the level of the audited bodies (see section 3 of the report) with regard the audit objectives 1 to 5 mentioned above, work effectively, except for:

- Audit objective 1, for the programming period 2014-2020; and
- Audit objective 2, for the programming period 2014-2020, and
- Audit objective 4, for the programming period 2007-2013 and 2014-2020.

where the qualification is significant (systems work partially, substantial improvements are needed - category 3).

The national authorities should:

- a. Cancel the public contribution in respect of 1 operation identified as being in breach of Article 4(c) of Act No 159/2006 should be applied;
- b. Verify all grants awarded on or after 9 February 2017 for all concerned 2014-2020 ESF operational programmes to ensure that they were awarded in compliance with Article 4c of Act No 159/2006 and from 2 August 2018, Article 61 of the Financial Regulation 2018, as concerns possible conflict of interests situations that may have affected grants awarded to any beneficiary. Financial corrections and cancellation of the related public contribution should be implemented for any irregular operations identified by this verification.
- c. In line with the obligation under Article 36 (3) of Regulation (EU, Euratom) 1046/2018, improve the management and control systems in place to identify any cases of non-compliance with Article 4 (1) and 4c of Act No 159/2006 or Article 61 of the Financial Regulation 2018 to ensure that no further grants are awarded in breach the rules on conflict of interests.
- d. Advise of any actions taken or proposed to be taken for the non-compliance of Mr Babiš with Articles 4(1) and 4(c) of Act No 159/2006.

The above opinion is based on the evidence gathered in the context of our audit concerning the scope defined above.

LIST OF ANNEXES

Annex I: Importance of recommendations

Annex II.a: List of errors in the sample

Annex II.b: List of systemic errors

Annex III: List of projects selected for audit of Key Requirement 2

Annex IV: List of projects selected for audit of Key Requirement 4

Annex V: Opinion of the Czech Ministry of Justice