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"Fisheries and Maritime Affairs"

JOINT AUDIT STRATEGY FOR STRUCTURAL ACTIONS

2007-2009

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1. INTRODUCTION

This document outlines the audit strategy proposed for each of the Structural Funds and the Cohesion Fund for the 2007-2009 period, setting out the main **objectives**, the **risks** identified and the **actions** to be undertaken to address these risks.

The document has been prepared jointly by the audit units of the four Directorates-General responsible for the audit of the Structural Funds and the Cohesion Fund (SF DGs) and covers the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agricultural Guidance and Guarantee Fund (EAGGF) guidance section, the Financial Instrument for Fisheries Guidance (FIFG), the Cohesion Fund (CF) and the Instrument for Pre-Accession Assistance (IPA).

The joint audit strategy was issued for the first time in 2005 following the recommendation from the Commission communication of August 2004¹ on specific actions to promote coherent audit methodologies between the Commission services working in the framework of shared management. The objective is to synchronise audit strategies between the Funds as far as possible and promote a common approach, so that there is a coherent focus for the audit work. This will have particular relevance for the work of assessing the management and control systems established by the new Member States, the preparation for the closure of the 2000-2006 programming period, and the arrangements for the programming period 2007-2013. The audit strategy is reviewed and updated annually, as necessary.

1.1. Audit strategies under shared management

For the part of the Community budget implemented under shared management, the Member States are principally responsible for setting up management and control systems which are in compliance with Community requirements, for verifying that the systems function effectively through audits by designated bodies, and for making financial corrections. The Commission nevertheless remains ultimately responsible for the execution of the budget. It must therefore seek reasonable assurance that the systems for management and control of Community funds established in the Member States are in conformity with the Community regulations and function so as to provide sound financial management. For this purpose audits are carried out in the Member States by the Commission services themselves or by private audit firms working under the Commission's supervision.

Given the multi-annual nature of the structural instruments, the large number of authorities responsible for their implementation in the Member States, and the limited audit resources available to the Commission, not all areas will be audited each year nor over the entire programming period, by the Commission itself. It is therefore necessary to adopt a medium-term strategy for seeking reasonable assurance concerning the legality and regularity of the claims paid, for determining the significance of the risks when this assurance cannot be attained, and for recovering irregular expenditure.

¹ C (2004) 3115

1.2. Legal Framework

Article 274 of the Treaty stipulates that the Commission shall implement the budget under its own responsibility. The Member States co-operate with the Commission to ensure that appropriations are used in accordance with the principles of sound financial management.

Currently, the audit strategy covers three programme periods, 1994-1999, 2000-2006 and 2007-2013, which are governed by three different sets of regulations (Council Regulations 1260/1999 (Structural Funds) and 1164/94 (Cohesion Fund), as amended², the corresponding Commission Regulations 438/2001 and 1386/2002³ for the current period and Council Regulation 1083/2006 and Commission Regulation 1828/2006 for the new period). The regulations require the Commission to review the management and control systems presented by the Member States and, in cooperation with the Member States, to verify the effective functioning of these management and control systems, inter alia by undertaking on-spot-checks for this purpose. The Commission must satisfy itself that these systems meet the standards required by the Council and Commission regulations, and make known any obstacles which they present to the transparency of checks and to the Commission's discharge of its responsibilities under Article 274 of the Treaty.

1.3. Methodology

The audits are carried out in accordance with the guidelines in the audit manuals of the Structural Funds and the Cohesion Fund. International auditing standards, as issued by the International Federation of Accountants (IFAC) or the International Organization of Supreme Audit Institutions (INTOSAI), are taken into account as much as possible, in order to ensure general compliance. The Structural Fund audit manual will be revised for the new regulations – see section 4 for further details.

1.4. Reporting

Communication of the results of the audit work is done through various means to the interested parties. Audit reports are the main output. An audit report includes a description of the audit testing performed, the findings following an audit mission, generally gives an opinion, and sets out the basis for corrective actions, as recommended by the responsible Directorate General. The follow-up process subsequent to the issue of the audit report is equally important since it includes recommendations (or, in the case of major weaknesses, action plans) specific to the Member State on correcting major deficiencies in their management and control systems. The Member States also receive

² Article 38(2) of Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds (OJ L 161, 26/06/1999, p.1) as amended and Article 12(2) of Council Regulation (EC) No 1164/94 of 16 May 1994 establishing a Cohesion Fund (OJ L 130, 25/05/1994, p.1), as amended.

³ Article 6 of Commission Regulation (EC) No 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds (OJ L 063, 03/03/2001, p.21), as amended and Article 5 of Commission Regulation (EC) No 1386/2002 of 29 July 2002 laying down detailed rules for the implementation of Council Regulation (EC) No 1164/94 as regards the management and control systems for assistance granted from the Cohesion Fund and the procedure for making financial corrections (OJ L 201, 31/07/2002, p.5).

timely feedback on the submission of their annual control reports concerning the programming period 2000-2006⁴. At the end of each year an assessment is made based on the audit work of the Directorates General, the results of the analysis of the annual control reports of the Member States, information from audit reports received from the national audit bodies, and from audits of the European Court of Auditors and other Structural Funds DGs, and the up-to-date information obtained from the last bilateral meetings with protocol partners. This assessment of the functioning of the management and control systems will provide conclusions as to whether there are significant deficiencies. Therefore, this assessment is an essential part of the input to enable the Structural Funds DGs to provide assurance annually on the expenditure for which they are responsible.

1.5. Budget

The Structural Fund DGs, along with the responsible authorities in the Member States and beneficiary countries, manage slightly more than one-third of the Community budget. Financial Resources for operational expenditure in 2007 (in (€) payment appropriations):

Activity/Fund	Operational Expenditure
European Regional Development Fund and other regional interventions	23 027 016 068
Cohesion Fund	4 941 967 816
Pre-accession Interventions related to the Structural Policies	446 450 000
European Social Fund	11 326 752 000
EAGGF Guidance	3 260 971 025
FIFG	837 672 198
Total (of financial resources managed by the SF DGs)	<u>43 840 829 107</u>

1.6. Materiality

The audit work takes account of the approach to materiality agreed by the four Directorates General for the purposes of the Annual Activity Report (AAR) and set out in the "Guidelines for assessment of materiality of deficiencies in Member States' management and control systems under shared management for the purposes of Annual Activity Reports". The concept of materiality is vital to identifying deficiencies to be disclosed in the AAR and determining which ones are significant enough to warrant a reservation. Reservations should be made in respect of significant deficiencies in the systems in the Member States or beneficiary countries where the resulting risk to the Community budget is material. Significant deficiencies are identified on the basis of a qualitative assessment taking account of relevant factors such as whether the deficiency relates to a key control element, the number and duration of such deficiencies, the importance of the systems affected, compensatory measures, the underlying cause of

⁴ Article 13 of Regulation 438/2001 and Article 12 of Regulation 1386/2002.

such deficiencies and corrective and timely actions taken by the Member State. Such deficiencies will be considered “material” where the sum of the amounts quantified as “at risk” from the cases of significant deficiency exceeds 2% of the total payments made for the year in question under the ABB (Activity Based Budgeting) activity, or where there are special factors in relation to the qualitative aspects of the deficiencies, or a high level of risk for the budget for a number of preceding years, which give rise to a high reputational risk for the Community institutions.

2. AUDIT OBJECTIVES AND GENERAL RISK ASSESSMENT

Overall objectives

The overall objectives of the activity of the audit units in the Structural Fund Directorates General are to seek reasonable assurance that **the management and control systems** established and implemented by Member States and beneficiary countries i) **comply with requirements of the Community regulations** and ii) **are functioning effectively** to prevent and detect errors and irregularities and assure the legality and regularity of the expenditure declared to the Commission.

In the event that deficiencies are identified in the systems, recommendations for remedial actions are made, and suspension of payments and financial corrections could be undertaken.

Overall risks

The management of structural actions carries an inherent risk since they are delivered by a multiplicity of organisations and systems, and involves hundreds of thousand of diverse operations. Eligibility of expenditure is determined by compliance with rules and conditions fixed at Community and national level which can lead to complexity and risk of misinterpretation.

The prime overall risk to the European Commission is that it will fail to obtain the annual discharge for its management of the Funds, by failing to satisfy the discharge authorities that it has properly fulfilled its responsibilities to ensure smooth functioning of systems by the Member States and beneficiary countries, and to initiate financial corrections in case of irregular expenditure.

The risk to the Authorising Officer by Sub-Delegation is that he or she will authorise payments in respect of irregular expenditure declared by the Member State or beneficiary country and will not have the reasonable assurance on the underlying transactions as required for the declaration in the Annual Activity Report. The risk presented by each category of expenditure is a function of:

- the materiality of the expenditure concerned;
- the reliance which can be placed on the Member States’/beneficiary countries’ management and control systems;
- the quality and quantity of audits undertaken by the Member States’/beneficiary countries’ audit bodies;
- the sensitivity of the sector concerned for the reputation of the DG/Commission;
- the complexity and nature of operations co-financed.

This risk is mitigated by:

- sound financial management and control systems;
- the certification of the regularity of expenditure by the responsible authority in the Member State or beneficiary country;
- the application of the provisions of the Charter of Authorising Officers by Delegation, which sets out the Commission's responsibilities as regards checks on operations;
- in relation to ISPA and IPA, the ex ante controls carried out by the EC delegation ;
- exercise of the regulatory framework to suspend payments or to make financial corrections in the light of ex post audit findings;
- the effective functioning of the financial circuits of the DG for processing payment claims.

In general, systemic risk is minimized by the implementation of a sound audit strategy, which takes account of the risks identified. An audit strategy takes account of the high priority accorded by senior management to the overall risks referred to. The implementation of a sound audit strategy not only provides for the management of identified risks but also should be engendering systemic improvements and this should lead to a reduction of errors.

3. PRIORITIES IN 2007

In the framework of the multi-annual audit strategy, and in a period of cumulative challenges for the Structural Funds audit function, the following **five main priorities**, outlined in detail in sections 4-8 of this document, are addressed by all the concerned Commission services in 2007:

- Commission Action Plan towards an Integrated Internal Control Framework. The Commission services are committed to work towards an integrated audit approach. The Structural Fund DGs have incorporated into their audit work plans for 2007 the specific actions required from the Commission Action Plan. (section 4)
- Assurance on the functioning of the management and control systems for the 2000-2006 period. In 2007, audit work will include the follow-up of implementation of recommendations from previous audits carried out, the monitoring of the implementation of specific actions plans agreed with Member States and further audit work to increase coverage⁵ in certain Member States, both in terms of systems audits and sample checks. (section 5)
- Assurance to be placed on the work of the national audit bodies (winding-up bodies in preparation for closure 2000-2006). A new audit enquiry will examine and assess the audit work of national audit bodies and in particular the winding-up bodies, in order to place reliance in preparation for closure. The methodology for this new audit enquiry is currently being

⁵ Coverage is calculated as the value of the contribution of programmes audited as compared to the total contribution.

developed jointly between all four SF DGs and the audit work will be coordinated to obtain synergies. (section 6)

- Assurance on the set-up and the functioning of the management and control systems for the 2007-2013 period. The overall objectives for 2007 are a) to ensure that the management and control systems are designed according to the new regulatory requirements at the programme negotiations stage and b) to ensure that the new regulatory requirements for the submission of the audit strategy and compliance assessment report are implemented in a correct and timely way. A technical meeting with Member States has been arranged by the Commission for end of March on these topics. (section 7)
- Closure of the 1994-99 programming period. All four SF DGs have as the overall objective to finalise any follow-up work and any related financial correction decisions. (section 8)

4. COMMUNITY INTEGRATED INTERNAL CONTROL FRAMEWORK

The Commission Action Plan towards an Integrated Internal Control Framework, adopted on 17 January 2006, sets out a list of 16 concrete actions to be implemented by the Commission services which address weaknesses that have so far prevented the European Court of Auditors from granting the Commission a positive DAS. The implementation of these actions, in cooperation with the Member States, will demonstrate that they have put in place the conditions necessary for the effective control of European Union funds.

The Structural Fund DGs are key players in the process. A state-of-play on some of the actions concerning the shared management areas of the budget is as follows:

Action 1- Simplification - The DG Regional Policy (DG REGIO), DG Employment, Social Affairs and Equal Opportunities (DG EMPL) and DG Fisheries and Maritime Affairs (DG FISH) have contributed to ensuring that the legal provisions in the Council Regulations and the Commission's implementing regulations relating to control and audit provide a clearer and more precise framework. In 2007 the Commission will prepare guidance on implementation and provide training to national audit authorities (see action 9).

Action 9- Improved Coordination – The action plan calls for increased coordination of audit work and sharing of audit results between the Commission services and between the Commission and Member States. In fact, the most cost-effective way of making systems effective in preventing and correcting errors in transactions is to integrate the activities of the Commission and the Member States under the "single audit" approach, involving coordination, exchange of information on the results of controls, dissemination of guidance and good practice, and the adoption of common control objectives and standards.

Coordination between the Commission and Member States

The 2006-07 annual bilateral coordination meetings have been brought forward between 20 November 2006 and 6 March 2007, in order to be able to include any relevant conclusions in the Annual Activity Report. More emphasis is placed in the

meetings on the audit strategies, coordination of audit work and methodology issues, such as sampling and materiality. The various funds may also have their own additional meetings with Member States. For example, DG EMPL holds its annual “mutualisation” meetings. The objective of these meetings is, the same as above, to share audit results with the Member States and therefore the Commission can draw part of its assurance level on systems from the national audit results. In 2006, as annual co-ordination audit meetings had been brought forward, the “mutualisation meetings” were generally planned as part of such meetings, usually taking place in Brussels, in order to avoid duplications and to make the best use of audit resources.

At last year’s “Homologues’ Group” meeting in Poland, the Commission undertook to assist the audit authorities for the new programming period by providing more regular technical meetings; for end of March 2007 such a meeting is planned to focus on the compliance assessment and the audit strategy documents to be submitted by the audit authorities within 12 and 9 months of programme adoption. Training will also be offered during 2007 to all Member States on the work of the audit authorities under the new regulations.

By improving coordination, the Commission will be able to increase the reliance to be placed on the work of national audit bodies. In this respect, it is intensifying efforts in 2007 and onwards as discussed in actions 14 to 16 below and through the new audit enquiry on the reliance to be placed on the national audit work (section 6). All this is an ongoing activity to promote an integrated internal control framework.

Coordination with other Structural Funds

The Structural Fund DGs coordinate their strategies to produce the joint audit strategy and are working towards a more complete alignment of audit procedures. In 2006 the database of all national authorities had been completed and the DGs had incorporated procedures for informing other services of audits common to all funds, for facilitating the exchange of audit results or for arranging joint audits. For the 2000-2006 programming period, a coordinated audit approach is planned for the enquiry on the reliance to be placed on the national audit bodies in preparation for the closure of programmes (see section 6). A common audit approach will be developed between DG REGIO and DG EMPL for the new programming period, which will begin with the review of the compliance assessment report and the audit strategies in 2007 (see section 7). The planning for the training in the Member States, the technical meetings and the working groups formed on the revision of the SF audit manual and the new enquiry include participants from both the SF DGs.

Action 10 – Cost of Controls – DG REGIO and DG AGRI assisted DG BUDGET in defining a common methodology for estimating the cost of controls. It was decided to limit this action only to ERDF for the Structural Funds and the EAGGF Guarantee section. Representatives from the DG REGIO launched the exercise end of 2006 and have visited Wales, Portugal and Hungary, who agreed to participate in the pilot phase, to introduce the methodology and explain their role in testing the methodology. It is expected that the launch to all the Member States will take place in April 2007 after which an analysis document will be produced on the costs of controls by end of 2007.

Action 14- Guidance- The Commission issued four guidance notes in 2006, - 1) good practices on first level day-to-day management checks, 2) good practices on the certification checks by the paying authority, 3) the guidance note on the recoveries

information to be provided by Member States and 4) the closure guidelines for the 2000-2006 period. For 2007, the Structural Fund DGs are committed to producing guidelines on financial corrections for public procurement irregularities, closure of INTERREG programmes and updating the guidance already provided under 1) and 2) above for the new period.

Action 15- Contracts of Confidence – The Commissioner of DG REGIO signed the first Contract of Confidence for ERDF with Wales in the Homologues Group meeting in Warsaw on 25 September 2006. A second Contract was signed with Austria in December 2006. At least two other EU15 Member States are potential candidates, as well as two potential candidates among the new Member States. Further audit work will be carried out in 2007 to provide the basis for these arrangements. The promotion of this initiative has driven generally the improvements in the coordination of audit work and has created a bench-marking procedure. The key elements of this initiative have been incorporated in the new Council Regulation 1083/2006 under Article 73.

Action 16- Coordination of audit standards- It is necessary that all Member States perform audit work according to the same generally accepted audit standards. In this respect, a working group to revise the Structural Funds audit manual according to the new regulations, and to introduce the application of international audit standards, has been set up between DG REGIO, DG EMPL and DG FISH. The new manual will act as a point of common reference for all Member States and the Commission services. The Member States will be consulted throughout 2007, either through written procedures or via technical meetings, for their comments on the content of the sections to be included. Furthermore, audit methodologies are discussed in bilateral coordination meetings and national auditors are encouraged to participate in audits performed by the Commission in order to share best practices.

5. ASSURANCE ON THE FUNCTIONING OF THE MANAGEMENT AND CONTROL SYSTEMS IN 2000-2006

5.1. EU25

Specific objectives and risks

For the programmes concerning the period 2000-2006, for all the Funds concerned, the risk remains that the management and control systems may still be affected by material weaknesses. In some cases the Commission does not yet have sufficient evidence that deficiencies detected have been satisfactorily remedied, whilst in others coverage of systems is not yet sufficient. Therefore, there is a need for the Commission to increase its assurance.

For the **ERDF**, based on the previous audit work, specific risk areas identified affecting key elements of the systems mainly concern insufficient management verification checks by Management Authorities and/or Intermediate Bodies and deficiencies in the certification and/or audit functions. Other key elements of the system also detected as weak include the separation of functions and inadequate audit trails. In the area of public procurement, the main issues concern irregular complementary works, the misapplication of the selection criteria and problems in tender evaluation.

Therefore, there is still a need for the Commission to increase its assurance on the functioning of the management and control systems in a number of Member States. The specific objectives will be, in the light of the residual risk determined for each of the countries concerned, to ensure a timely and adequate implementation of previous recommendations and to verify systems not previously audited and where the risk assessment indicates a high risk.

An audit enquiry was started in mid-2004 to examine the effective functioning of key elements of the management and control systems in Member States for mainstream programmes. The audits comprise two phases, a systems audit and an audit of a sample of projects selected on a representative basis. The on-the-spot audit work initially planned has been concluded by end 2006 for EU 15 and will be concluded as at end of June 2007 for EU 10.

At the end of 2006, 65 programmes had been audited under the EU15 enquiry - "verification of effective functioning of the systems for 2000-06 period" representing 31% of the number of the mainstream programmes and 50,8% of the planned ERDF contribution.

For EU 10, at the end of 2006, 9 programmes had been audited representing 60% of the number of the mainstream programmes and 71,5% of the planned ERDF contribution.

For the ESF, concerning EU15, the ESF risk analysis identified a number of ESF programmes, which presented a relatively higher degree of risk meriting closer attention in the form of systems audits. Out of a total of 212 ESF programmes for EU15, more than 160 programmes have been audited between 2002 and 2006.

At the end of September 2006 only a few programmes identified as 1st priority group⁶ remain uncovered. These uncovered "high risk programmes" merit to be audited in 2007 in order to verify the compliance of the systems in place, taking into account the possible national audit results.

It is worth mentioning that the remaining uncovered programmes for EU 15 – outside the high risk areas – cover only a reduced part of the total ESF appropriations for EU 15 in 2000 - 2006: at the end of 2006 around 20% of ESF appropriations for 2000/2006 EU 15 have not been audited yet by DG EMPL audit unit (over than 90 programmes, most of them at regional level).

The "mutualisation" (sharing) of ESF audit results with the Member States, in an integrated audit approach, allows to draw assurance from national audit results for 44 of these programmes, provided that audit reports are provided to the Commission in due time. This is among others the case for the French, Portuguese and Greek regional programmes, which constitute the bulk of the 2nd priority group⁷, and for which national audit results have been received and taken into account in determining DG EMPL level of assurance.

Some of these programmes will be covered in 2007 and possibly in 2008, with a greater emphasis on substantive testing after a first systems audit, due to the late stage in the

⁶ high / medium risk - high/ medium value

⁷ high risk / low value or low risk / high value

programming period. Audit activity for substantive testing after systems audits can be partly outsourced.

Despite this, due to the large number of smaller regional programmes, some of these programmes will still remain uncovered at the end of 2009 (particularly the 3rd priority group⁸). Commission's assurance at closure for these remaining programmes will therefore have to be drawn from the national audit activity and winding-up declarations established by the Article 15 bodies. For the ESF concerning EU10, because of the limited number of programmes and systems and the inherent risk linked to the new Member States, the objective of DG EMPL was to ensure a 100% coverage by end of 2009. The audits still to be performed concern only 3 EQUAL programmes constituting a low financial risk. Priority will be given instead to the follow-up of audit recommendations concerning the remaining programmes in EU 10 countries.

At the end of 2006, the audit activity of DG FISH ex-post control sector covered all the programmes (EU25) for which it is the “lead service”, representing 88% of the total planned **FIFG** contribution for the period. In addition, audits were carried out for 6 programmes where DG REGIO is “lead service”, representing another 2,8% of the total allocation for FIFG in the period.

In 2006, DG Agricultural performed 19 audits on 2000-2006 **EAGGF-Guidance** programmes, concentrating mostly on the quality of management controls (Article 4 of Regulation 438/2001), and on specific agricultural elements (Regulation 1257/1999), with some work on the quality of Article 10 controls. Of the 19 audits on 2000-2006 programmes six were carried out in EU-10 and thirteen in EU15 Member States.

For EU10, there are two elements that reduce the risk for EAGGF guidance: (1) 8 of the 10 countries were involved in the SAPARD programmes. SAPARD supported the same measures as EAGGF guidance, so these countries already have experience in Operating these measures; and (ii) SAPARD had an important institution building role: the SAPARD agencies, which were accredited by the Commission, have now become the Paying Agencies for EAGGF Guarantee, and the key implementing bodies for EAGGF Guidance. The analysis of systems' descriptions, required under Article 6 of Regulation 438/2001, was completed in 2006. Six conformity audits were undertaken in 2006, others will be carried out if indicated by the risk analysis. Given the common measures and/or bodies, these audits will be carried out wherever appropriate together with audits of SAPARD or EAGGF Guarantee expenditure.

For the **Cohesion Fund** similar risk areas have been identified during systems audits carried out. For the Member States which acceded in 2004, the audit work carried out in 2006 focused on follow-up audits to verify the effective implementation of recommendations made on the systems in 2005 and further compliance testing of project expenditure. Special emphasis was also given to reviewing the work of the national audit bodies including checking the quality of systems audits, sample checks and other issues in relation to the work of the preparation of the audit certificate.

Given that the closure of significant numbers of Cohesion fund projects is now underway, which will increase and continue over the coming years, it is considered that the main remaining risk concerns the reliability of the work of the winding-up bodies and

⁸ medium / low risk – medium / low value

the assurance that can be placed on the declarations received at closure. Audit work should therefore focus on the objective of seeking assurance on the reliability of the winding up declarations (see section 6 below).

Given the high risks identified concerning tendering and contracting, a specific thematic enquiry on public procurement was launched in 2005 focusing on contracts awarded after accession in the new Member States with both a preventive objective and a corrective objective. The enquiry which initially targeted contracts co-financed by the Cohesion Fund was extended to cover also ERDF financed contracts in 2006 in EU 10 Member States. The risk assessment undertaken for EU 15 indicates that, at present, the audit work undertaken in the framework of the systems audit adequately covers the public procurement issues in most Member States. However, this enquiry will be extended to a limited number of EU 15 countries in 2007.

Audit work foreseen in 2007-2009

The audit approach for additional audit work needed to obtain assurance on the functioning of the systems is tailor-made to the situation in each Member State. For each Member State an analysis of the previous audit work, including findings, follow-up and conclusions, has been performed and the remaining risks have been assessed.

For **ERDF** (EU 15), it is considered that (a) there is still a need to increase assurance on the functioning of the management and control systems in 6 EU 15 countries (namely, Belgium, Greece, Italy, France, Ireland and Portugal), by auditing additional programmes, (b) follow-up on the implementation of action plans is scheduled for four countries and (c) nineteen missions (phase I and phase II) have been planned to increase the coverage of EU 15 programmes representing 9 new programmes with a total amount of € 461,68 million to be controlled in 2007. The total amount covered at the end of 2007 will represent 53.87% of ERDF mainstream. For the remainder of the Members States assurance on the effective functioning of systems can be obtained principally from work of national audit bodies and therefore follow-up audit work will be limited.

For ERDF (EU 10) the audit work in 2007 will be the completion of the current enquiry in the first half of the year. Sixteen missions (phase I and phase II⁹) have been planned to increase the coverage of EU10 programmes representing 7 new programmes with a total amount of € 194,89 million to be controlled in 2007. The total amount covered at the end of 2007 will represent 96,39% of planned ERDF mainstream contribution.

Overall, the audit coverage for EU 25 should be sufficient by the end of 2007. The audit work for 2008 and 2009 will be determined on the basis of the findings from audits performed during 2007, under the current enquiry and the enquiry under section 6, and the updated risk analysis. It will be targeted on the follow-up of remaining material deficiencies.

A separate audit enquiry for the Community Initiative (CI) INTERREG III has been launched in 2006 by DG REGIO and will be further implemented in 2007 as planned. The main risk factors, confirmed before the on-the-spot audit work was launched, consist of the general risk factors identified for ERDF and in the specific factors linked to the

⁹ Phase I - a systems audit and Phase II - a sample of projects is audited (sample checks/expenditure checks/substantive testing).

multi-national nature of programmes and operations, to the type of expenditure co-financed and to the complex management and control systems put in place by Member States. The audit approach includes an audit of the systems (phase I) and expenditure checks (phase II).

In 2006, 5 programmes were audited (phase I); in 2007 a further 3 programmes will be audited (phase I) and expenditure checks (phase II) will be carried out on selected projects of up to 6 audited programmes in order to substantiate the assurance obtained from the systems audits.

Follow-up audit work will be carried out where major deficiencies have been detected in phase I work. Furthermore, a self-assessment questionnaire, covering the risks detected in previous audit work, will be sent to the non-audited programmes representing 64 % of €5.7 billion net committed under the CI, in order for the Directorate General to re-assess the risks in the overall CI by the end of 2007.

Finally, specific guidance will be given to the bodies in charge of all 81 programmes in order to prepare for the winding-up declarations due in 2009.

Like DG REGIO, DG EMPL assessed the level of assurance for each ESF OP based on all available audits of the **ESF** systems to-date and classifying these ESF systems and programmes for EU 25 in three groups: Group 1- systems are globally satisfactory as regards key elements of the system, Group 2- systems are satisfactory, but with limitations and improvements necessary in key elements and Group 3- Systems which present major weaknesses in key elements.

Under groups 1 and 2, the DG's objective is to confirm this rating on systems, by way of a pilot exercise of on-the-spot substantive testing in 2007. The objective is to perform audits on random samples of 10 to 30 projects, and test if the underlying transactions are legal, regular and correct and that the principles of efficient and sound financial management have been applied. In case significant errors rates are detected under a particular programme, a further sample may be audited for this particular programme. Should a sample be drawn which has already been audited under the sample checks on operations according to art. 10 Reg. (EC) No 438/2001 (5% checks), this would allow for a re-performance of the audit work, in order to validate the audit work carried out by the audit body in the MS. Based on the results of the 2007 pilot exercise, DG EMPL will decide whether to pursue this audit engagement for 2008/2009.

For programmes and systems included in group 3, the main weaknesses identified concern the key elements of the systems. These group 3 programmes require a more specific and individual follow-up (case by case approach) with the view to a) verify the corrections proposed and carried out by the Member State (including action plans) on the concerned declarations of expenditure for the years / systems concerned and/or b) verify the better compliance and functioning of systems, after appropriate corrective actions have been taken (through systems audits/ substantive testing).

For **FIFG** the next three years will include the follow-up of recommendations issued by its auditors or by the other audit services of the Commission or the Court of Auditors placing more emphasis on the Member States classified as high risk. Also a review will be undertaken of FIFG systems of multi-fund programmes, particularly concerning those accepted by the other SF DGs, but not yet checked on-the-spot, in order to increase the coverage for the level of assurance obtained.

For **EAGGF-Guidance**, a risk analysis covering all agricultural expenditure (Guarantee, Guidance and SAPARD), indicates the need to carry out further audits in specific Member States. These are planned for 2007 which will concentrate on the controls over respect of Community rules, especially compliance with the specific rules for agricultural subsidies and on the quality of management controls. The remainder of the period will mainly focus on the work of the winding-up bodies as discussed under section 6 "Assurance to be placed on the work of national audit bodies".

For **Cohesion Fund**, the main focus of the audit work in 2007 to 2009 will be on obtaining assurance for closure of Cohesion Fund projects. This will build on the extensive work already carried out for EU 4, which has covered both an examination of the work of the winding up bodies and the audit of a sample of closed projects. As from 2007, a new closure audit enquiry will start which will extend the work to the countries which acceded in 2004 with the same objectives as for EU 4, and will be continued as necessary for EU 4. The objectives and methodology of this enquiry will follow closely the one for the Structural Funds which is further explained in section 6. It will also include audits of a sample of closed projects.

The second priority will be completing the follow-up and financial correction procedures for CF projects audited in 2004-2005 and follow-up audits will be undertaken if necessary, to verify the effective implementation of recommendation made in 2006 and further substantive testing of project expenditure where this has not been possible previously due to slow implementation of CF projects. The third important activity to be conducted in 2007 will be the contribution to the assessment of every winding-up declaration relating to CF projects 2000-2006 (desk check).

Starting in 2007, the new instrument for pre-accession assistance **IPA** will replace ISPA. The IPA instrument of Council Regulation 1085/06 will be an accession driven instrument and is split into five components of which two – regional development component and cross border cooperation – are the main concerns for the Cohesion Policy.

The audit enquiry for 2007-2009 by DG REGIO and DG EMPL will be governed by the following main objectives:

- to seek reasonable assurance that the systems for the management and control of IPA projects are in compliance with the requirements of the applicable regulations and function effectively;
- to ensure an efficient implementation of IPA projects to respect regulatory obligations and requirements by seeking assurance that declarations of expenditure submitted to the Commission are legal and regular.
- to contribute to prepare Croatia, Turkey and the Former Yugoslav Republic of Macedonia (FYROM) for the introduction of the Cohesion Fund and Structural Funds by providing guidance on the requirements of the Community regulations.

5.2. New Member States –Bulgaria and Romania

Romania and Bulgaria have joined the European Union as from 1 January 2007. The ongoing ISPA projects in both countries have been transformed after accession into

Cohesion Fund projects and will exceptionally be governed by the 2000-2006 legislative framework for the Cohesion Fund until closure of the individual projects. According to Regulation 1386/02, Member States shall within three months of project adoption communicate systems descriptions of the management and control systems to the Commission which shall satisfy itself that the set-up of the systems meet the requirements of the regulation.

During the pre-accession period, 30 audit missions were carried out in both countries including audits to verify the effective functioning of management and control systems, missions to verify the readiness to waive the ex-ante controls on tendering and contracting (EDIS) and audits of individual projects.

Specific objectives and risks

Given the nature of the findings during the pre-accession phase and despite a very intensive audit and advice effort from the Commission services, both countries must be assessed as high risk countries deserving special attention in 2007-2009 to control the following main risks:

- transition from ISPA to CF represents an inherent risk as the national authorities have to become fully aware of the applicable legislation ensuring that the structures represent reliable management and control systems;
- difficulties in implementing EC rules on public procurement represent a significant risk. The risk is increased by the substantial differences existing between pre-accession rules and Community Directives and the fact that final beneficiaries have not systematically been involved in tendering and contracting;
- limited administrative and technical capacities demonstrated by high turnover of staff and insufficient human resources. The need for administrative capacity will more than double as the funds will increase dramatically;
- absorption capacity of funds including meeting the n+ 3/2 rule and
- combating corruption.

The specific objectives of the enquiry concerning the new Member States are to:

- seek reasonable assurance that set up of the systems for the Cohesion Fund meet the requirements of the applicable regulations (1386/02, Art. 5)
- seek reasonable assurance on the effective functioning of the management and control systems so as to provide legality and regularity of payment claims for Cohesion Fund projects
- seek reasonable assurance on compliance with public procurement rules (PRAG rules) including follow-up of Commission's decisions to waive the ex-ante control on tendering and contracting in 2006 and
- advise and prepare the Bulgarian and Romanian authorities, and in particular the parts of the institutions lacking pre-accession experience for the 2007-2013 programming period.

Audit work foreseen in 2007-2009

In total, ten audit missions are planned in 2007 to both countries to achieve the above-mentioned objectives. The close co-ordination and co-operation with the audit bodies in both Member States, will continue to be an area of priority. The audit work is expected

to increase in 2008 and 2009 following the start of the implementation of the operational programmes for the 2007-2013 period.

6. ASSURANCE TO BE PLACED ON THE WORK OF THE NATIONAL AUDIT BODIES (WINDING-UP BODIES IN PREPARATION FOR CLOSURE 2000-2006)

Specific objectives and risks

There is a risk that Member States may not take action over the next 2-3 years to be adequately prepared for closure of the current programmes, in particular because of the overlap with the start-up of the new programmes which will make a high demand on resources. As the winding-up declaration is the key basis for the Commission's assurance, high priority is given to reviewing the work of the winding-up bodies, with the objective of placing reliance on that work for the remainder of the period and in the context of closure.

Work to-date

The audit strategy followed by the Commission so far for 2000-2006 programmes for acquiring a level of assurance for most systems and programmes on the basis of systems audits, followed by sample checks and by the follow-up on systemic errors over the period should reduce the risk of any major problems appearing at closure and make the assessment of winding-up declarations, to be delivered by the 31 March 2010, easier.

For the closure of the 2000-2006 programmes the Commission may concentrate its closure audit activity on programmes and systems which have been allocated a lower level of assurance or for which high error rates (above set materiality) have been detected during its sample checks or reported by the Member States.

Moreover, the situation of the winding-up bodies (art. 15 Reg. (EC) 438/2001) is different from the programming period 1994-1999. Regulatory requirements are well-known since the beginning of the period; most winding-up bodies have been appointed early on, and in most cases they have closely monitored the results of systems audits and 5% checks on projects, on an annual basis through the preparation of the annual control reports and the annual co-ordination meetings.

New audit enquiry

A new audit enquiry will be carried out in 2007/2008 with the objective of verifying the reliability of the audit work of the winding-up bodies (EU 25) in relation to Articles 10 and 15 – 17 of Reg. 438/2001. The enquiry will be based on a risk assessment and will enable the Commission to conclude whether they can rely on the audit work carried out by Member States as a main source of assurance for the remainder of the programming period and in the context of programme closure. The state of preparation of all winding-up bodies would be verified against the guidance provided in the Guidelines on closure of assistance (2000/2006) from the Structural Funds¹⁰ adopted by the Commission on 1 August 2006 and already widely disseminated in the Member States.

¹⁰ C(2006)3424

The objective is to verify whether the winding-up declarations can be relied upon and will be based on sufficient audit work with adequate follow-up of all findings and irregularities. Where this is the case, the Commission services will be in a position to decrease their own audit work accordingly. Where material weaknesses in the functioning of the winding-up bodies are discovered, the Commission will work with the Member States in the framework of recommendations or action plans in order to remedy these weaknesses so as to ensure that there is a sound basis for programme closure.

A joint Enquiry Planning Memorandum is currently being produced between Directorates-General AGRI, EMPL, FISH and REGIO which will set out the objectives, scope and methodology. The work will be related to programmes co-financed under the EAGGF-guidance, ESF, FIFG and ERDF. The Directorates-General will coordinate their work in order to achieve synergies and to avoid overlap. Where Article 15 bodies are common to several Funds, the DGs may decide to rely on each other's audit work to make the best use of limited audit resources. The fact that winding-up declarations for EAGGF-Guidance need to be delivered by 30 June 2009, 9 months earlier than the rest of the Funds, will be taken into account.

By the end of 2008 sufficient audit work should be performed so as to conclude on the level of reliance to be placed on the winding-up procedures. Further audit work is planned in 2009 as regards the follow-up of any deficiencies detected so as to prevent any foreseen problems at closure.

7. ASSURANCE ON THE SET-UP AND FUNCTIONING OF THE MANAGEMENT AND CONTROL SYSTEMS (EU27) 2007-2013

For the new programming period, the structural actions will cover the European Regional Development Fund, Cohesion Fund and the European Social Fund. The rules for the management of the Cohesion Fund have been integrated to that of the European Regional Development Fund. The Commission has issued a single implementing regulation 1828/2006.

The funding for rural development and fisheries will be subject to specific sectoral legislation outside the Structural Funds. For the EFF, the implementing regulation is very similar to EC 1828/2006 and the audit work planned is aligned with the work as described below.

Specific objectives and risks

The overall objective is to ensure that the new regulatory requirements – audit strategy, compliance assessment and annual audit opinion – are implemented in a correct and timely way so as to provide the SF DGs with assurance on the set-up and functioning of the systems from an early date. In particular the focus will be on the reliability of the work of the audit authorities.

The risks are that the new procedures will not be fully understood, that they will not be properly complied with and that the responsible bodies will not have the know-how and/or resources to apply them correctly. For ERDF and Cohesion Fund, there are also

specific risks linked to the concentration of Funds in two Member States, Poland and Spain, which together will account for about 30% of these Funds, and to the volume of funds which will be managed by the two new Member States, Bulgaria and Romania. The same is true for ESF, except that almost half of the ESF budget is allocated to four decentralised Member States: Poland, Germany, Italy and Spain.

The majority of programmes for the new period should be adopted by the last quarter of 2007. The adoption of the programme is the starting date for two actions: submission of the audit strategy by the audit authority within 9 months and submission of the systems description with compliance assessment report within maximum 12 months. The first annual control reports from audit authorities will be due by 31.12.2008 and the first bilateral meetings for the new period are envisaged to take place in April/May 2009. A common methodology is being developed between DG REGIO and DG EMPL for the audit work. The approach may be differentiated to take account of Member States which use the option available under Article 74 of Regulation 1083/2006 (proportionality provision).

Audit work foreseen for 2007-2009

In 2007 the focus will be:

- Prior to adoption, audit services are consulted and provide advice during the negotiations on the draft programmes concerning the provisions on management and control issues,
- training actions in Member States in particular for the audit authority and bodies under its supervision, with regard to the new regulations on issues of financial management and control and the development of audit methods,
- guidance for new period –revision of the Structural Funds Audit Manual (SFAM), updated guidance on first level management checks and certification checks and guidance on financial corrections.
- Provision of guidance to Member States and preparation for the treatment of audit strategies and compliance assessment.

In 2008 for most new programmes the audit strategy, systems descriptions and compliance assessment reports will have been received, and the main work will be the continuation of the examination and treatment of these documents (objective 1 below).

Audit work from second half of 2008 and in 2009 will focus on reviewing the start-up of the work of the audit authorities in all Member States together with systems audits on high risk Member States to verify the set-up of systems (objective 2). Audit work will focus on the reliance to be placed on the work of the audit authorities (objective 3).

Objective 1: Commission to make observations on audit strategies and compliance assessments submitted (desk review, 2007-2008)

The transmission to the Commission of a compliance report and opinion on the set-up of the systems is a new audit requirement of the 2007/2013 regulatory framework, to be performed by the audit authority or an independent audit body of each programme. If the Commission does not provide observations in 2 months, the compliance report and opinion are deemed accepted by the Commission. For systems that are the same as in 2000/2006, the analysis of the compliance assessment will take into account audit results from the current period (based on the levels of assurance already attributed to audited systems and programmes and weaknesses noted). For Member States considered high risk, in financial terms, fact-

finding visits, or preventive systems audits, may be carried out with the objective of preventing problems being detected after the compliance assessment process and providing guidance if required to the audit authorities.

The transmission of an audit strategy for each programme is an important improvement of the control framework for the new programming period. The Commission should comment on the proposed audit strategy within 3 months following reception¹¹. The Commission's analysis may involve making requests for clarification of key elements in view of the importance of the audit strategy as forming the basis for the national audit plans and as the source of assurance on which the audit authorities will be providing their annual audit opinions. This audit activity cannot be outsourced.

Procedures have been put in place and agreed between the two DGs on how to carry out the review of these documents and guidance will be given to the Member States to assist them with the process of preparation of these documents (see section 4 under Action 9).

Objective 2: Assurance on the functioning of the systems (on-the-spot activity, 2008/2009)

The Commission, in planning the assurance to be obtained through its own audit work for particular programmes, will perform on-the-spot audits. Programmes and/or systems will be selected for audit based on the results of a risk analysis that will take account of the following elements:

- the results of the analysis of the initial compliance assessment and opinion
- the validation of the audit strategy and national audit schedule for 2007/2008
- the annual audit opinion by the audit authority, to be provided for the first time by 31 December 2008
- the error rate identified in the sample of operations audited under article 16/17 of Commission implementing regulation
- the limited experience of some new MS (BG, RO mainly, but also EU10).

Where the Commission concludes that the risk is low pursuant to Article 73, which depends on the conditions that the national audit strategy is satisfactory and that reasonable assurance on the effective functioning of the systems has been obtained on the basis of audit work by the Commission and by the Member State, then it can formally reduce its own audit work.

Objective 3: Assurance from the audit opinions and annual control reports - Review of the work of the Audit Authority (as from 2009)

The enquiry will follow a similar methodology as described in section 6, in view of determining if the Commission can rely principally on the annual audit opinion delivered by the audit authority for all programmes. In any case, on-the-spot audit activity in the case of re-performance and evaluation of the audit authority's work cannot be undertaken before 2009 and the reception by the Commission of the first annual audit opinion under article 62(1)(d).

¹¹ article 62(4) of Regulation (CE) No 1083/2006

8. ASSURANCE ON THE CLOSURE OF PROGRAMMING PERIOD 1994-1999

Each Directorate General is following up outstanding findings from the audit work performed for the 1994-1999 programming period and in some cases completing any remaining audit work.

The overall objective for all Funds is to finalise the follow-up of audit work for this period by the end of 2007 and complete any remaining contradictory and financial correction procedures under Article 24 of Regulation 4253/88.

9. RESOURCE IMPLICATIONS

The audit strategy identifies actions and priorities in order to make the best use of resources. An estimate of resource needs for the next three years will be based on the actions as foreseen in sections 4-8. Any changes in the audit schedule during the year will take the effect on resources into consideration, in order to forecast recruitment requirements more accurately.

The audit work for the next three years is expected to increase due to the overlap of the three programming periods, the two new Member States of Bulgaria and Romania and the work to be done on the reliance of the audit authority. Moreover, the follow-up of financial correction cases will also require additional resources. Each DG decides how many resources will be made available based on its own procedures and priorities. Currently audit resources vary between SF DGs: DG REGIO has 58 full-time auditors working on the ERDF, the CF and IPA. DG EMPL has approximately 22 auditors of which 2 are part-time, working on ESF. DG AGRI has 8 full-time equivalent auditors working on the Guidance section, as the staff is not allocated entirely to the Structural Funds. DG FISH has approximately 4 full-time equivalent auditors working on the FIGG.

Additional resources are available under framework contracts with external audit firms, for which special care has been provided on the necessary guarantees for the quality of the audits to be delivered. However, the need to allocate existing in-house resources to the supervision and the follow-up of the external audit teams remains.

10. CONCLUSION

This updated joint audit strategy for the Structural Funds and the Cohesion Fund will be sent for information to the Member States, the Budgetary Control Committee of the European Parliament, and to the European Court of Auditors. It will be reviewed and updated, as necessary, at the end of the year, in order to establish a permanent framework for audit activity for the structural instruments.