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COMMISSION STAFF WORKING PAPER

**ANALYSIS OF ERRORS IN COHESION POLICY FOR THE YEARS 2006-
2009_ACTIONS TAKEN BY THE COMMISSION AND THE WAY FORWARD_**

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ANALYSIS OF ERRORS IN COHESION POLICY FOR THE YEARS 2006-2009 ACTIONS TAKEN BY THE COMMISSION AND THE WAY FORWARD

1. INTRODUCTION AND EXECUTIVE SUMMARY

European cohesion policy aims at strengthening economic and social cohesion within the European Union by reducing the gap in the level of development among regions. The policy is implemented on the basis of shared management, where Member States are primarily responsible for setting up well functioning management and control systems, which are able to prevent, detect and correct irregularities. The European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF) account for the vast majority of the spending of cohesion policy.

Since 2007, in its annual report, the European Court of Auditors (the Court) has reported an estimated error rate for cohesion policy as a whole for each budget year (2006-2009) based on an independent, annual random sample of transactions. The Court's estimated level of error for cohesion policy has been considerably higher compared to other policy groups of the EU budget in the years analysed. While year-on-year variations in the number of errors detected may be influenced, *inter alia*, by the stage in the multiannual implementation cycle of co-financed programmes, the estimated error rate decreased significantly in 2009, when the majority of the Court's audited transactions consisted of projects from the current (2007-2013) programming period¹ for the first time. The Commission found similar results in an enquiry carried out in 2009 to estimate the risk in the first payments for the 2007-2013 programming period, based on a representative sample of expenditure submitted up to May 2009². Nevertheless, it should be noted that not all programme authorities had started to make substantial payments in 2009 for the 2007-2013 programming period, thereby limiting the population of payments from which the Court and the Commission could draw their sample for current programmes for that year. The error rate remains high and will certainly fluctuate in the future, in particular as the implementation of the current programming period reaches maturity and the volume of payments increases in subsequent years as demonstrated in the annual activity reports of the Commission services concerned.

The Commission services now have at their disposal increasing insight due to four years of the Court's results in terms of estimated errors, the results of the Commission services' own audit work (reported most recently in the 2009 and 2010 annual activity reports) and since 2010 enhanced information provided by national Audit Authorities appointed for each operational programme. In the context of the Commission's 2008 Action Plan, this is therefore an appropriate point in time to evaluate the lessons learned from these audit results in relation to the effective functioning of the management and control systems. This is especially important in order to outline the actions still necessary to continuously improve the overall

¹ The lower limits of the error rates published by the Court were 12% in 2006, 11% in 2007, 11% in 2008 and 3% in 2009.

² With an error rate estimated between 3% and 5% (see Impact Report of 18 February 2010 on the Commission Action Plan to strengthen its supervisory role, COM (2010)52 final).

systems in all Member States as well as to tackle specific issues and to cooperate with specific programmes' authorities in Member States where errors occur more often.

This paper presents the methodology used for quantifying errors and an analysis of the errors found by the Court and the Commission, by providing an analysis of the main types of errors identified during the years 2006-2009 and their geographical distribution, as well as the on-going key actions to prevent and remedy detected errors and ensure a continuously effective implementation of systems for the 2007-2013 programmes. It builds on this assessment to highlight further improvements proposed by the Commission to increase the assurance for the 2014-2020 programming period.

This analysis builds on the 2008 Commission's action plan to strengthen its supervisory role, which was implemented from 2008 to 2010. With the action plan, the Commission has implemented targeted corrective actions to tackle the high error rates reported by the Court since 2006 that covered, until DAS 2008, the previous 2000-2006 programming period. These actions resulted in increased implementation of financial corrections, more targeted audit activity on the most risky areas and preventive actions in view of the 2000-2006 closure³.

As for the current 2007-2013 programming period, the Action Plan set out preventive actions to ensure robust management and control systems at the start of the new period which have now been taken over in the day to day work of the Commission services concerned.

As the ESF contribution to errors has decreased significantly since 2008 (see section 4.1), this paper emphasises actions taken mostly in the ERDF and Cohesion Fund area, as the principal errors found remain mainly therein. From the analysis presented in this paper, the following conclusions can be drawn:

- The overall cohesion policy delivery system is providing increased assurance compared to the previous period, as demonstrated in the positive development in the Court's error rate for 2009, by the national audit results for the same year reported at the end of 2010 and by the 2009 and 2010 annual activity reports of the Commission services. Nevertheless, the increased level in the total number of reservations for Cohesion as a whole indicate areas of weaknesses in the management and control systems in some areas.
- The principal errors found are concentrated in a relatively small number of programmes in a limited number of Member States.
- Specific types of errors such as public procurement and eligibility issues persist throughout several years and need to continue to be addressed with strong corrective and preventive actions.
- Tackling such problems requires very close co-operation with responsible national and regional authorities which are primarily responsible for preventing and detecting errors, by persistently applying preventive actions through, for example, guidance and training.

³ As reported in implementation and impact reports about the Action Plan, see COM(2010)52 final

- Corrective actions and in particular, the systematic and timely implementation of interruptions and suspensions of payments by the Commission need to continue as an impetus to improve the management and control systems.
- The Commission's proposal for the 2014-2020 period continues to build on these actions to further increase the assurance by notably strengthening the accountability by Member States while retaining the Commission's tool for corrective actions, in accordance with the proposed new rules for shared management in the draft Financial Regulation.

Considering the variety of terms used in the context of this paper, a glossary has been provided in Annex I. Annex II provides detailed information on reservations of the cohesion policy services made in the Annual Activity Reports. Annex III gives examples of most typical errors.

2. THE ASSURANCE BUILDING PROCESS

Cohesion policy⁴ accounts for approximately one third of the EU budget with total payments in 2010 amounting to approximately EUR 37.7 billion⁵.



The management of cohesion policy carries an **inherent risk** since its programmes are delivered by numerous organisations and systems, and involve very large numbers of diverse projects. Furthermore, eligibility of expenditure is determined by compliance with rules and conditions fixed at both EU and national level, which can lead to complexity and risk of

⁴ Cohesion Policy is funded through the European Regional Development Fund (ERDF), the Cohesion Fund (CF) and the European Social Fund (ESF).

⁵ This includes EUR 7 066 million for the ESF, EUR 22 091 million for the ERDF, EUR 7 957 million for the CF and the remaining are payments related to the pre-accession assistance (IPA), the Solidarity Fund and the European Globalisation Adjustment Fund.

misinterpretation. **Assurance on the systems** is gradually built up over the programming period through various levels of controls.

Before programme implementation, the Commission obtains assurance through the description of the management and control systems. The compliance assessment process involves an independent body providing an opinion on the setup and compliance of the systems with regulatory requirements, reviewed by the Commission before it makes the first payment of interim expenditure to a programme.

During programme implementation, the Commission obtains assurance on the basis of various levels of controls at national level: management verifications carried out by managing authorities, certification of each payment claim by certifying authorities, regular audits carried out by audit authorities culminating in an annual audit opinion for each programme. The Commission also relies on the results of its own audit work together with audits of the Court and OLAF investigations.

At closure, the programme audit authority must submit a closure declaration supported by a final control report. On the basis of that report and its own closure work, the Commission proceeds with the final payment and closure of programmes only when it has obtained reasonable assurance that all programme expenditure is legal and regular and free from material error.

3. CONCEPTS AND DEFINITION OF ERRORS⁶

An *error* occurs when a transaction is not carried out in accordance with the legal and regulatory provisions⁷, therefore rendering declared (and reimbursed) expenditure irregular. Errors are mainly detected and reported through audits and controls of national and Community bodies.

Two important precisions need to be made:

- (1) An **error does not mean that funds have disappeared, been lost or wasted**. Despite the existence of errors, only parts of the projects were affected. However, the funds have been used for their intended purposes and for the approved projects, though there were weaknesses in project implementation or ineligible expenditure detected, that do not necessarily affect the quality or delivery of the projects.
- (2) An **error does not mean fraud**. While errors involve breaches of certain of the conditions of funding, fraud is intentional deception. It is crucial to note that suspected fraud in cohesion policy constitutes a marginal percentage, i.e. 0.26% of payment appropriations for the 2000-2006 programming period⁸. Nonetheless, in line with the zero tolerance to fraud policy followed by the Commission, the cohesion policy services have developed an anti fraud strategy and are currently further improving their fraud prevention and detection tools.

⁶ Annex I provides a comprehensive glossary with detailed definitions of terms and notions.

⁷ See annex II for applicable regulations.

⁸ Source: Report from the Commission on the protection of the European Union's financial interests and the fight against fraud – 2009, Commission Staff Working Document Statistical Evaluation of Irregularities, 14.7.2010, SEC(2010) 898 final.

It is widely acknowledged that it would be unrealistic to assume that no errors occur in practice and, consequently, a degree of tolerance regarding the appropriate level of accuracy is to be considered acceptable⁹. In terms of audit techniques this is called the "*materiality level*" and it is set at 2% of the audited amounts.

In its annual reports, the Court classifies errors according to¹⁰:

- Whether it is possible to measure how much of the amount paid by the Commission is affected by the error, i.e. whether errors are *quantifiable* or *non-quantifiable*. When a quantifiable error is above 2% of the audited amount, it is classified as *serious*, whereas when it is less than 2% it is classified as *limited*;
- The nature of the error, in particular *eligibility* (a payment does not meet the eligibility rules), *occurrence* (reimbursement of a cost which is not proven to have been incurred) and *accuracy* (payment incorrectly calculated).

The *error rate* provides an estimation of the overall financial impact¹¹ on the entire population of payments made by the Commission within a financial year and is based on the audit of a representative sample of transactions. Statistical methods are used annually by the Court of auditors and the national audit authorities, and occasionally by the Commission. They allow to set the size and select the sample of operations to be audited and to calculate a *most likely error (MLE)*, as well as a range (*interval*), within which the auditor has confidence that the error rate in the population lies (this range is between the *lower error limit (LEL)* and the *upper error limit (UEL)*). The most likely error is then compared with the materiality level, in order to reach a conclusion on whether the population (expenditure) is affected by material error (MLE above 2%) or not (MLE below 2%).

The *frequency of error* is another indicator which is used by the Court to show how many of the transactions audited in the sample are affected by errors of any kind. Therefore, the frequency of errors presents the proportion of the sample affected by any type of errors and indicates how widespread errors are likely to be within a policy group as a whole. Frequency of error is thus a different indicator than the error rate¹².

These tools help auditors to establish a picture of the claimed expenditure in a given year of multiannual programmes and express an opinion about them. While the Court's error rate gives an estimation of the error in the population of payments related to a given financial year, multiannual programmes in Cohesion are subject to various layers of controls, which take effect over a period of several years. For this reason, the Commission underlines that the error rate given by the Court cannot and should not be directly transposed in amounts of financial corrections to be imposed on Member States. This has also been acknowledged by the Court. Indeed, during the follow up of the Court's errors by the Commission, Member State authorities sometimes present additional audit evidence which may reduce/eliminate the error and allow accepting the expenditure under examination.

⁹ See ECA brochure "The DAS methodology":

<http://eca.europa.eu/portal/pls/portal/docs/1/1671539.PDF>

¹⁰ Source: Court of Auditors Annual Report for 2009, Annex 1.1, point 9.

¹¹ Source: Court of Auditors Annual Report for 2009, Annex 1.1, point 10.

¹² Source: Court of Auditors Annual Report for 2009, Annex 1.1, point 10.

Also the system of quantification of errors by the Court differs from the one used by the Commission or Member States when deciding how to respond to misapplication of the public procurement rules. The Commission, according to its established methodology¹³, which is also used by many national authorities, applies flat-rate corrections which try to address proportionately the risk of damage to the EU budget¹⁴.

4. NATURE OF QUANTIFIABLE ERRORS REPORTED BY THE COURT IN DAS AUDITS 2006- 2009

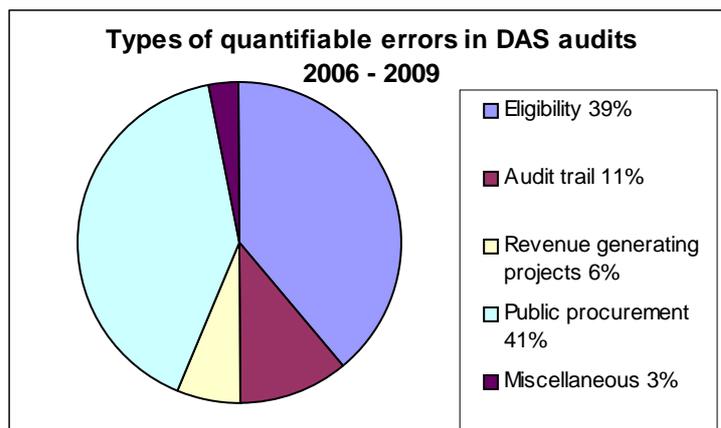
The contribution of ERDF and Cohesion Fund projects in the Court's annual audits of transactions for 2006–2009, as compared to the contribution of ESF projects has slightly increased over years. On average over 2006-2009, seven out of ten projects sampled and audited by the Court were ERDF/CF projects and three were ESF projects.

The share of errors for ERDF/Cohesion Fund and ESF largely reflects this ratio for 2006 and 2007, while the ESF share in errors significantly decreased in 2008 and 2009.

¹³ Guidance note COCOF 07/0037/03-EN of 29/11/2007

¹⁴ For example, if a contracting authority publishes a tender using a negotiated procedure instead of an open procedure, the Court may quantify this as a serious 100% error, as it considers that the principle of fair competition is not observed and that the award of the contract to the best bidder is not guaranteed. The Commission would normally apply a 25% financial correction on the value of the contract considering that the publication of the tender still guarantees a certain level of openness and access to competition and that the potential damage to the EU budget is below 100%. On the other hand, if discriminatory criteria (e.g. the requirement to have previous experience in a specific sector/type of business) are used, this may be considered as affecting the outcome of the tender procedure. In such a case, the Court may decide not to quantify the error (though it would report a non-quantifiable error). On the contrary, the Commission would normally apply a financial correction, varying from 5% to 25% depending on its perception of the seriousness of the case and the financial risk to the EU budget.

4.1. ERDF and Cohesion Fund - types of quantifiable errors in DAS audits 2006-2009¹⁵



Analysis of the quantifiable errors reported by the Court for the years 2006-2009 demonstrates that non-compliance with **eligibility** criteria together with errors in **public procurement** rules or procedures are the most common types of errors detected. A smaller proportion of reported errors was related to **inadequate audit trail** and to the incorrect calculation of the co-financing rate for **revenue generating projects**.

While some errors stem from breaches of Structural Funds regulations (notably rules concerning eligibility and revenue generating projects), other errors are related to breaches of EU regulations and directives which are not specific to the regulatory framework of cohesion policy (notably public procurement rules). The errors specific to cohesion policy reflect the inherent complexity of grant assistance in general.

Types of errors specific to cohesion policy

The most important category of Cohesion-related errors is **eligibility errors**, which accounts for 39% of cumulative quantifiable errors in 2006-2009. These include:

¹⁵ The data presented here are based on the quantifiable errors identified by the Court of Auditors in the years 2006 to 2009. This analysis does not intend to give an exhaustive view on errors detected, as its main purpose is to show the general trend of nature and geographical spread of the errors found. Furthermore, this analysis is made by the Commission on the basis of information received from the Court of Auditors and does not prejudice any analysis the Court itself may publish on the results of its own audits, or the conclusions drawn by the Court in its Annual Reports for the years in question. The Commission underlines that this analysis serves as the basis for the Commission to draw lessons from errors detected over four years and outline actions it is undertaking or will undertake.

The share of the various categories of errors in the overall error rate was calculated on the basis of quantifiable errors, while non-quantifiable errors were not taken into account for the presented analysis. This corresponds to the Court's approach of estimating the overall extrapolated error rate on the basis of quantifiable errors only. In cases of findings where the error rate was established based on different types of errors (i.e. multiple errors) the error rate was adjusted accordingly or allocated to the predominant category of error).

The analysis was done as follows: error rates per audited project were classified into different categories of errors and attributed to the audited programmes in the respective Member State. These rates were then aggregated for all categories and Member States and weighted, so as to compare the relative contribution of each type of errors to the cumulative quantifiable errors reported.

- **Errors in the selection of projects** (about half of all eligibility errors), which occurred when some criteria and rules on the procedure to be applied were not observed, including for retrospective projects¹⁶.
- **Ineligible costs** (one third), which occurred when costs not corresponding to the eligibility rules were declared. These irregular costs mainly referred to cost categories which are not eligible, costs incurred outside the eligibility period, costs related to projects other than the co-financed ones, costs incurred in areas/regions which were not eligible and double declaration of the same costs.
- **Other types of eligibility errors** involved mainly incorrect calculation of the co-financing rate and declaration of recoverable VAT.

Another category of errors are weaknesses in the **audit trail**, which accounts for 11% of quantifiable errors over the years analysed. These weaknesses include failures to keep records at all levels in order to be able to reconcile aggregate amounts declared to the Commission. Nevertheless, reported audit trail errors have declined as in 2009 these represented 8% compared to 21% in 2006. This indicates that the 2007-13 management and control systems are more efficient in preventing these errors due to enhanced management verifications carried out by the Managing Authorities.

Finally, errors linked to the complex issue of **revenue generating projects** accounted for 6% of quantifiable errors reported over the period. According to the regulations, estimated revenues should be deducted when deciding the eligible expenditure to be co-financed. Errors occurred when revenues were not deducted or calculated incorrectly and thus the co-financing rate was too high. This is an area where additional clarity has been identified in the future regulatory framework.

Types of errors not specific to cohesion policy

Public procurement errors have contributed approximately to 41% of the cumulative quantifiable errors found. The most frequent public procurement weaknesses were related to¹⁷:

- **Inadequate assessment of bids.** The main subtypes of errors correspond to the specification of unlawful selection and award criteria, such as criteria on the technical ability of economic operators that were too specific and discriminatory. Inappropriate award criteria related to cases where selection criteria were used as award criteria or to cases where an unlawful "average prices method" was used as award criterion. Other frequent types of errors referred to procedural weaknesses during the evaluation process, such as unjustified decision of the evaluation committee to directly affect the outcome of the tender.

¹⁶ For a definition of retrospective projects, see glossary in Annex I.

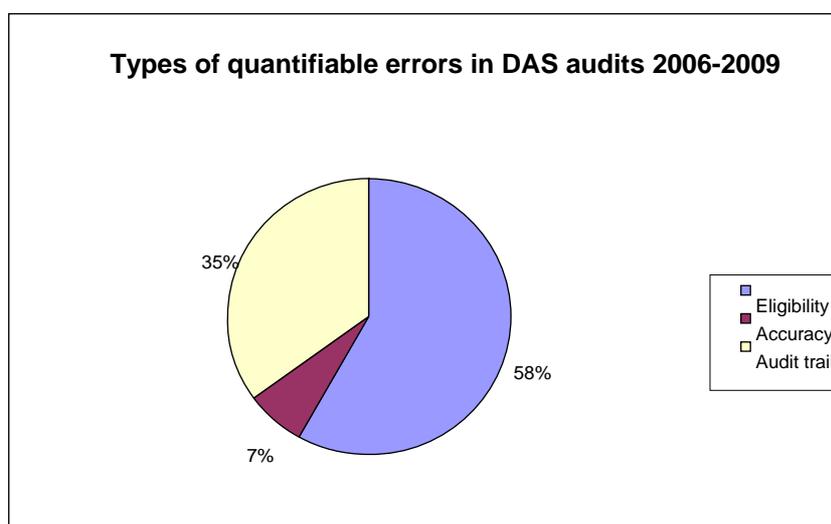
¹⁷ The results of the Court's audits related to errors in public procurement largely correspond to the results presented in the "Working Document prepared by DG Regional Policy on the main audit findings regarding application of public procurement rules in Member States found in projects co-financed by ERDF and the Cohesion Fund under cohesion policy" (CC/2011/08 EN) was presented in May 2011 to the Advisory Committee for public contracts and intended to open a discussion with Member States' representatives on how the application of public procurement rules in the area of cohesion policy could be reinforced and what can be done to reduce the number of errors related to public procurement.

- **Absence of tendering or award of contract based on inappropriate tendering procedure** (use of direct award or negotiated procedure where an open procedure should have been used), **in particular the award of supplementary contracts without competition.**
- **Non-compliance with publication requirements**, in particular as regards formal aspects. This related to cases where the tender was advertised, i.e. access to contracts by economic operators from other Member States was ensured, but not fully in compliance with requirements laid down in the public procurement directives and the applicable national rules.

4.2. ESF - types of quantifiable errors in DAS audits 2006- 2009

The share of ESF projects in the cohesion policy errors reported by the Court has been low in recent years. While in 2006 and 2007 errors in ESF projects contributed by 38% and 44%, respectively, to the cumulative quantifiable errors for cohesion policy in 2008 and 2009 this percentage had dropped to 2% and 7% respectively. This positive development is further confirmed by the relatively low error rate estimated by DG Employment, Social Affairs and Inclusion for 2009 based on the information provided for the first time, at the end of 2010 by the ESF Audit Authorities concerning expenditure certified in 2009¹⁸. This significant improvement is due to the implementation in 2008 of a strict policy on interruptions and suspensions and to the first positive impact of certain specific simplification measures adopted, which are explained in section 6.3.

The table below shows the types of errors found by the Court in the period 2006-2009:



Source: ECA's Annual Reports 2006-2009. Audit trail errors are classified as either "eligibility" or "other compliance issues" following the classification applied by the Court in the relevant annual reports.

Over the period under analysis, the most typical quantifiable errors found by the Court in ESF are the following:

- **Eligibility issues** encompass in particular non-eligible participants, non-eligible direct and indirect costs, payments after or before the eligibility period, ineligible expenditure declared on a flat-rate basis, non eligible costs of scholarship and public

¹⁸ See 2010 AAR of DG Employment, social affairs and inclusion (page 45)

allowances, revenues not deducted when calculating eligible expenditure or calculated incorrectly, services paid but not delivered and ineligible VAT.

- **Accuracy issues** concern incorrect allocation of direct and indirect costs, no duly justified overhead allocation method, mistakes in calculation of expenses, non-respect of the real cost principle, over-declaration of costs, incorrect calculation of co-financing rates and multiple declaration of staff costs and finally incorrect or absent tendering procedures.
- **Audit trail issues** refer to absence of essential supporting documents.

It should be noted that in 2008 and 2009, no errors were detected by the Court regarding public procurement procedures in ESF.

5. GEOGRAPHICAL CONCENTRATION OF ERRORS

5.1. Programmes included in the Court's audits and errors found

ERDF/CF

During the years 2006–2009, the Court's independent random samples for ERDF/CF projects included transactions in operational programmes in a total of **18** Member States, with the annual samples including programmes in **7** to **11** Member States each year. For two Member States (**ES, EL**) transactions were sampled each year, transactions were sampled in another four Member States (**DE, IT, PL, PT**) for three out of the four years under analysis. The Court's samples also included in total 6 Interreg/Cross-Border programmes. No transactions from nine Member States (**AT, BE, DK, NL, SI, CY, FI, MT, IE**) were selected in the samples.

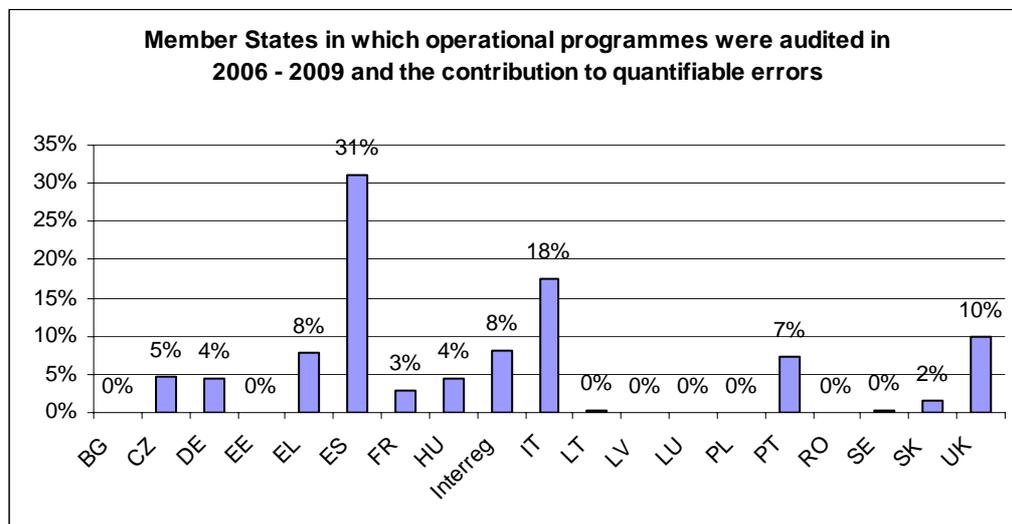
The analysis of ERDF/CF errors in the years 2006-2009 shows that¹⁹:

- Over the four years, nearly 60% of errors reported by the Court were identified in programmes in three Member States (ES, IT and the UK). In 2006, errors originating from these three Member States contributed to two thirds of the reported cumulative quantifiable errors. In 2007, two Member States (CZ, EL) contributed to approximately half of the cumulated quantifiable errors, while in 2008 two Member States (ES and IT) contributed approximately to two thirds of the cumulated quantifiable errors. In 2009, three quarter of the reported errors stem from one Member State (ES).
- The analysis shows that in these Member States, the reported weaknesses are concentrated in certain regional programmes only. Almost all errors in Italian programmes originated from three regions. Equally in Spain, a limited number of operational programmes contributed to three quarters of the detected errors. The analysis further shows that approximately half of the errors detected in the Italian programmes are due to errors in selection of projects, whereas in Spain

¹⁹ The analysis was done as follows: error rates per audited project were attributed to the audited programmes in the respective Member State. These rates were then aggregated for each Member State and weighted, so as to compare the relative contribution of each Member State to the cumulative quantifiable errors reported.

approximately half of the errors are a result of weaknesses in public procurement procedures.

The chart below presents the contributions of the programmes audited by the Court to cumulative quantifiable errors identified over the period, sorted by Member State²⁰.

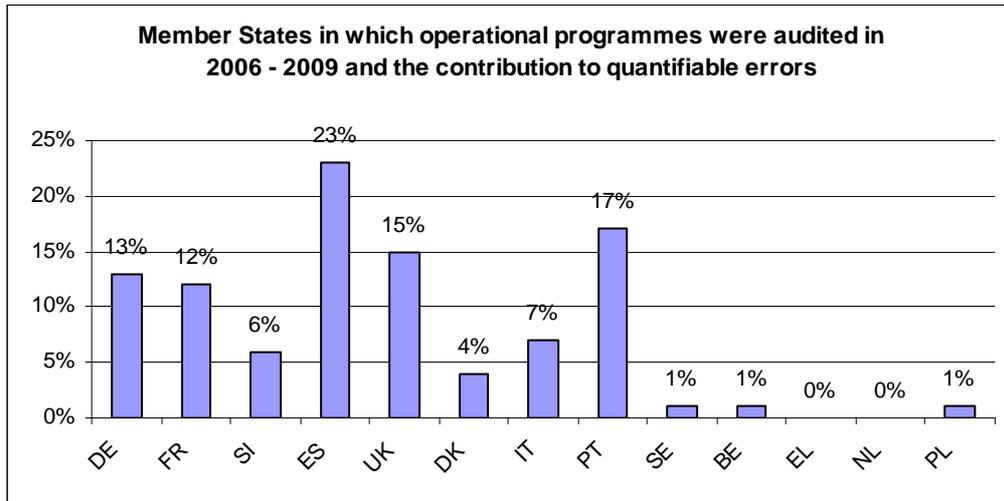


ESF

In the period 2006-2009 the Court performed audits on ESF operational programmes in 13 Member States. The table below shows the geographical distribution of errors over this period as detected by the Court²¹:

²⁰ It is underlined that the analysis is for illustrative purposes only. 0% indicates that no quantifiable errors were identified in programmes in the respective Member States (non-quantifiable errors may exist). Member States not shown in the chart were not covered in the years examined by the Court's random sample. It is noted that the Commission's analysis did not take into account the overall funds available to the Member States or the budget of the audited programmes. This disclaimer is particularly important, as some large programmes may have few errors, while smaller programmes may be over-represented in this chart. Moreover accession in 2004 and 2007 also led to limited financial resources for the concerned Member States for the previous 2000-2006 programmes, compared to previous Member States.

²¹ Same remark as for the ERDF / Cohesion Fund table above



Over the period, operational programmes in 3 Member States (ES, PT and the UK) account for 54% of the quantifiable errors found by the Court. This percentage reaches 90% when operational programmes in 3 additional Member States (DE, FR and IT) are included. However, as noted above, for 2008 and 2009 the errors found by the Court are limited and therefore their geographical distribution in those years is negligible.

5.2. Results of the audit work of the Commission – operational programmes in Member States assessed in the Annual Activity Reports

The results of the Commission's audit work are regularly reported in the Annual Activity Reports (AARs)²². Taking into account all relevant sources including audit opinions from national audits, results of its own on-the-spot work and those of the Court, where available, DG Regional Policy and DG Employment, Social Affairs and Inclusion have assessed all operational programmes for both programming periods and categorised them in four levels of assurance. The results of this analysis are summarised below:

ERDF/CF programmes

For 2010, out of 745 programmes and Cohesion fund projects for both programming periods, 41% (309) were classified as providing "reasonable assurance" while 49% (365) were classified as providing "reasonable assurance with moderate impact" of identified weaknesses on EU payments. A proportion of 8% (60) of the programmes were classified as providing only "limited assurance with significant impact" of identified weaknesses on EU payments and 1% (11) provided "no assurance".

Consequently, the Director-General for Regional Policy issued two reservations for 2010, one for each programming period. In relation to 2000-2006, 23 programmes/sectors/CF projects in BG, HU, IT, DE, LV, the NL and 9 Interreg programmes are under reservation, compared to 28 programmes/sectors in four Member States (BG, DE, IT and the UK, and 15 Interreg programmes) in the 2009 AAR. For the period 2007-2013 75 programmes in 10 Member States (BG, CZ, DE, EL, IT, LV, LT, ES, RO, the UK and 11 European Territorial co-

²² The assurance provided by the Directors general for Regional Policy and Employment, Social Affairs and Inclusion is qualified by the reservations they expressed. See in particular section 4 of their most recent reports issued on 31st March 2011 for the financial year 2010.

operation programmes) are under reservation. This implies an increase both in terms of programmes and of Member States compared to 2009²³, which has to be seen in relation to the increase in expenditure declared in 2010, the first year in which most programmes under the current regulatory framework were fully running thus increasing the inherent risk of error. Interim payments made to these programmes amount to 14.7% of total payments made by the Commission in 2010, while the programmes in two Member States, Italy and the Czech Republic, represent close to half of the estimated amounts at risk for 2010²⁴.

The Commission is taking specific actions in relation to the operational programmes subject to reservation. Besides being identified in the Annual Activity Report²⁵, payments to these programmes are also being interrupted when payment requests have been sent to the Commission and in some cases suspended²⁶. These programmes are consequently being specifically followed up, including in many cases with additional audit work on the spot or in high level meetings with the programme authorities concerned.

The analysis of all operational programmes by DG Regional Policy in its AARs over the last years (see tables in Annex II for programmes under reservation in 2007-2010) is largely in line with the above analysis of the geographical spread of errors reported by the Court. While for the majority of operational programmes there is sufficient assurance that the management and control systems function effectively, errors are concentrated in certain programmes. This shows that even if the stronger regulatory framework for the current programming period has started to produce positive effects on the assurance level, considerable support and control efforts are still needed in relation to programmes in reservation and major causes of errors according to the Court's results, public procurement processes and eligibility of costs.

ESF programmes

For 2010, out of 355 ESF programmes for both programming periods, 27% (96) were classified as providing "reasonable assurance" while 61% (216) were classified as providing "reasonable assurance with moderate impact" of identified weaknesses on EU payments. A further 9% (31) of the programmes were classified as providing only "limited assurance with significant impact" of identified weaknesses on EU payments and 3% (12) provided "no assurance".

Consequently, the Director-General for Employment, Social Affairs and Inclusion issued two reservations for 2010, one for each programming period. In relation to 2000-2006, 13 programmes in Italy, Spain, France and Germany are under reservation in DG Employment, Social Affairs and Inclusion's 2010 AAR, compared to 21 programmes in 2009's AAR (in the same 4 Member States, plus Belgium). Concerning 2007-2013 30 programmes in 9 Member States (AT, BE, BG, DE, IE, IT, SK, ES, and UK) are included in the 2010 reservation, slightly less than in 2009 (38 programmes in 6 Member States, BE, DE, IT, LU, RO and ES). However, it should be noted that the reasons for reservations in 2009 and 2010 are not comparable, since in 2009 the main reason for reservations was a disclaimer of opinion by the National Audit Authorities (for 28 programmes included in the reservation), which is not

²³ In total 98 programmes are under reservation in DG Regional policy's 2010 AAR for both 2000-2006 and 2007-2013 periods. The table in annex III to this document refers to 96 programmes as it does not include two reservations concerning Cohesion Fund projects/sectors in the 2000-2006 period.

²⁴ See DG Regional policy's 2010 AAR, page 69

²⁵ See tables on pages 68, 69 and 87 of the 2010 AAR of DG Regional Policy

²⁶ See section 6.3 for the number of payment interrupted or suspended in 2010 and 2011

anymore the case in 2010. Interim payments made to 2007-2013 programmes in reservation in 2010 amount to 9.7% of total interim payments made in 2010, which shows the effectiveness of the strict interruption/suspension policy followed by DG Employment, Social Affairs and Inclusion. The 43 operational programmes categorised with limited or no assurance are identified in the Annual activity report²⁷ and are subject to reservation, meaning that payments to those programmes are interrupted when payment requests are sent to the Commission and that the programmes concerned are suspended, where necessary, if the weaknesses identified have not been solved in the meantime. These programmes are also being specifically followed up, including in many cases with additional audit work by DG Employment Social Affairs and Inclusion on the spot.

The analysis of all operational programmes by DG Employment, Social Affairs and Inclusion in its AARs over the last years (see tables in Annex II for programmes under reservation in 2007-2010) is generally in line with the analysis of the geographical spread of errors identified in the analysis of the Court's sample. Errors are concentrated in a limited number of programmes, while for the majority of operational programmes there is sufficient assurance that the management and control systems function effectively. As shown in Annex II, operational programmes in 2 Member States (ES and IT) account on average in 2007-2010 for roughly 60% of all programmes under reservation, which has resulted in a significant number of interruptions and suspensions for the concerned programmes²⁸.

6. ACTIONS TAKEN AND THE WAY FORWARD

The analysis of the nature of errors and their geographical concentration has provided further ground for actions specifically targeted to prevent similar errors occurring in the future. It is equally fundamental to make adequate corrections when problems have already occurred. The Commission's supervisory role continues therefore to be focused on both preventive and corrective measures and can only be fully successful if carried out in partnership with committed national authorities.

This section provides information on ongoing actions as well as an outline of additional measures the Commission intends to adopt to increase the assurance for cohesion policy. These measures are also a reply to the concerns and requests made by the discharge authority, in particular in its discharge decisions and resolution for the 2009 budget²⁹.

6.1. Preventive actions - capacity building with Member States

In order to respond to the need for continued strengthening of administrative capacity across Member States and contributing to effective and robust management and control systems, the Commission works intensively with the concerned national authorities.

The Commission services participate in programme monitoring committees, annual meetings with managing authorities and in bilateral meetings to follow the implementation progress and detect any issues in management of programmes, to facilitate implementation in the context of

²⁷ See 2010 AAR of DG Employment, Social affairs and Inclusion, table on page 84

²⁸ See section 6.3 for the number of payment interrupted or suspended in 2010 and 2011

²⁹ See European parliament decision of 10 may 2011 on discharge in respect of the implementation of the general budget of the European Union for the financial year 2009, section III – Commission (A7-0134/2011); and the Report from the Commission to the European Parliament and the Council on the follow-up to the discharge for the 2009 financial year and its two annexes to be released in October.

the difficult economic circumstances and to further simplify rules and procedures. Technical meetings are regularly organised as part of the Committee for the Coordination of the Funds to exchange views of specific topics.

National and regional authorities receive continuous guidance from the Commission in the form of guidance notes and training, at the beginning of and during the programming period, including when changes are made to the regulatory framework. For example, "train the trainers" seminars have included the issues of public procurement, revenue-generating projects and how to best use simplified costs. During the first semester 2011, draft guidelines on criteria for financial corrections 2007-2013 were presented to this committee before the Commission's adoption, and in the second semester complementary guidance in relation to the annual control reports for national audit authorities will be presented. Also, a fraud risk scoring tool to further strengthen fraud prevention and detection is being developed by the Commission and will be shared with programmes authorities. Improving prevention and detection of fraud through, for instance, risk-based controls, is one of the key objectives of the recently adopted Commission Anti-Fraud Strategy³⁰.

As regards audit authorities, technical meetings are regularly organised with them to share experiences gained on different aspects on the assurance building. Topics covered in 2010 and 2011 include evaluation of the compliance assessment exercise, specific issues in relation to systems audits and audits of operations, audit approach to financial engineering instruments and additional guidance on treatment of errors and reporting in annual control reports and audit opinions. In addition, annual "Homologues Group meetings" of national and EU audit representatives have become a useful tool to strengthen co-ordination, exchange best audit practices and jointly reflect on future needs. Recent topics include audit methods on public procurement, financial engineering instruments, fraud prevention and State aid. In 2011, DG Regional Policy has participated in additional meetings with Audit Authorities in Italy, Spain and the Czech Republic to address specific issues.

Annual bilateral coordination meetings with audit authorities are organised during the first semester each year to monitor the effective implementation of the national audit strategy and audit plan, as well as to exchange audit results and follow-up on audit opinions and fraud – awareness raising.

6.2. Action to tackle specific issues and programmes/Member States

Concerning the main sources of errors as outlined in section 4 above (eligibility, including retrospective projects, audit trail, revenue generating projects, and public procurement) as well as the geographical concentration of errors, the Commission has, is and will take the actions as described below.

6.2.1. Action to tackle specific issues identified as bearing risk

Actions to tackle eligibility errors

The significant share of errors detected by Community auditors in relation to *non respect of eligibility rules at EU, national or regional level* underlines the need for continued attention to this area.

³⁰ COM (2011) 376 final.

As from the current programming period, the overwhelming part of eligibility rules are set by the Member States themselves and can therefore be tailored to the individual circumstances at national and regional level. This is in itself a simplification compared to the previous programming period. The Commission is actively working with national and regional authorities by encouraging them to simplify eligibility rules and by facilitating transfer of best practices. If deemed useful, the process can be organised into an advisory board for the 2014-2020 period.

Moreover, in the 2007-13 ESF regulation the concept of simplified costs was introduced and extended to the ERDF in 2009 laying the ground for a major simplification compared to the actual costs principle. The simplified costs system allows for reimbursement based on standard scales of unit costs, indirect costs according to a predefined flat rate percentage of direct project costs, as well as lump sum payments. In order to foster the implementation of the simplification measures, Member States have been given the possibility to submit the schemes they envisaged for the declaration of indirect costs at flat rate for an ex-ante check by the Commission. So far, 16 Member States have started to use this option for ESF and seven for ERDF. The Commission continues its efforts to provide support and guidance to Member States so that this possibility offered by the regulations leads to real simplification for all stakeholders.

To mitigate the particular risks identified with the so-called 'retrospective projects' the Commission is implementing the following actions:

- Providing relevant national authorities with both common and targeted guidelines to specific operational programmes to clarify under which circumstances such projects initially financed under national schemes can subsequently be included in EU funded programmes and if so, clarify eligibility rules and prerequisites from a legal perspective;
- Raising awareness of the relevant managing authorities and certifying authorities to adequately and timely check eligibility of retrospective projects with EU rules as soon as they are included in the operational programmes. This can for instance include targeted management verifications.

Revenue-generating projects

After receiving feedback from the implementing bodies on the complexity of application of the 2007-13 regulations on revenue-generating projects, based on the Commission's proposal and an analysis of costs related, the regulation was changed in 2008 and 2010 to exempt smaller and ESF projects from monitoring of revenue generated. This is further simplified for the 2014-2020 period, as presented in section 6.5.

Audit trail

Errors in audit trail are declining and the introduction in the 2007-13 period legal framework of a process of partial closure is designed to further decrease the risk of loss of documents by allowing to considerably shortening the time period required for the retention of documents.

Compliance with public procurement rules

The perceived complexity of EU rules on *public procurement* and of their implementation by national legislators led the Commission to announce in the Single Market Act that it will

make legislative proposals in 2011, with a view to simplify and update the public procurement legislation. Indeed, problems in relation to public procurement law remain one of the most important causes of errors for ERDF and CF projects. Audit evidence shows that delayed or incorrect transposition of EU directives into national legislation, difficulty to interpret the applicable rules, and weak administrative capacity in particular at local level are the most important reasons leading to errors in this area.

The Commission's actions are twofold: 1) To continue to pay attention to detecting and to correct all errors detected and 2) To continuously provide guidance to relevant national authorities, stressing at all occasions that compliance with applicable rules requires Member States to provide further guidance to implementing bodies.

At Commission level, DG Regional Policy and DG Internal Market have set-up a working group with a view to coordinating efforts towards the clarification of certain public procurement rules and the implementation of actions which could help reduce errors in projects co-financed by Structural Funds. Where recurrent weaknesses have been revealed or where major projects have a high inherent level of risk the two Directorates-General are also providing assistance to the Member States in their capacity building activities on the ground.

The Commission has discussed with Member States in the Advisory Committee on Public Procurement in May 2011 a report produced on frequent errors identified through Commission audits and leading to financial correction decisions being adopted. Member States were alerted about these recurrent audit findings and asked to share good practices and proposals to overcome deficiencies.

Numerous seminars, workshops, thematic presentations, training courses have been and will continue to be organised during 2011 and 2012. Events were held in 2011 in the Czech Republic, Slovakia, Hungary, Italy, Slovenia and Portugal.

DG Regional Policy is actively assisting Member States to tackle specific issues in the national management and control systems which could hamper the effective implementation of public procurement law. Relevant examples include Hungary, Greece, Poland, Bulgaria, Spain, Italy, the Czech Republic and Romania. Finally, DG MARKT is presently carrying out an action, "Going Local", aimed at increasing the knowledge of EU public procurement by local authorities.

Management and control of financial engineering schemes

The role of *financial engineering instruments* (FEI) in cohesion policy has increased significantly in recent years. Insufficient know-how and capacity to set up complex financing structures which may involve technical negotiations with financial institutions and correct and timely mobilisation of funding in favour of enterprises (SMEs) and projects (urban development) are important challenges for many regional authorities. Both DG Regional Policy and DG Employment, Social Affairs and Inclusion have identified the FEI as a potential source of complexity and carried out specific risk assessments underpinning thematic audits on implementation of FEI, which are starting in the second half of 2011. The Commission has, in August 2011 made a proposal to amend Council Regulation (EC) No 1083/2006 as regards repayable assistance and financial engineering to ensure better annual reporting on the progress of implementation of the financial engineering instruments.

Close and intense cooperation exists with the Member States drawing their attention to the complexity of such FEI, to the need to check their implementation on a regular basis through

management verifications and thematic audits to mitigate the main risks identified, such as irregular provisions in the agreements signed with the Funds implementing FEI, slow use of the FEI contribution or contribution of FEI to ineligible recipients. DG Regional Policy and DG Employment, Social affairs and Inclusion have:

- Elaborated and thoroughly discussed with Member States a guidance note on the implementation of FEI (adopted in February 2011)
- Proposed a common audit framework to audit the FEI together with the Member States' audit authorities (May 2011). Audit authorities were encouraged to conduct regular thematic audits on the implementation of FEI, on top of audits made in the context of the required sample checks that cover mainly the constitution of such funds in the early years of programmes' implementation.
- Furthermore, DG Employment, Social affairs and Inclusion has provided instructions in July 2011 to the relevant ESF audit authorities, asking them to perform specific audit work on FEI in order to properly cover their implementation, using the audit manual presented by the Commission, since in the case of ESF the use of FEI is increasing, and expected to increase even more in the future. DG Employment, Social affairs and Inclusion also intends to conduct audit work in order to cover specific programmes in this area starting in the second half of 2011.

6.2.2. *Action to tackle specific programmes/Member States*

Action plans and/or remedial measures have been put in place for all programmes in all Member States where serious weaknesses were identified in the Annual Activity Reports. Targeted audits are being carried out in order to identify the scale and sources of errors and to carry out the necessary corrections, thus considerably increasing the audit work on the spot³¹. In particular, the situation in the two Member States where certain operational programmes persistently account for a high share of the cumulative quantifiable errors reported by the Court, is being closely monitored. The specific actions implemented by DG Regional Policy and DG Employment, Social Affairs and Inclusion in these two Member States are summarised below:

ERDF/CF

In **Italy**, problems relate to systemic weaknesses identified at the level of audit and managing authorities, while there are also significant issues in the application of public procurement rules and selection of projects, including the eligibility of retrospective projects. It should be underlined that the problems detected are concentrated in few of the 28 Italian programmes to which ERDF contributes with EUR 21 billion in the present programming period.

As the implementation of programmes is completely decentralised, each programme is managed by its own managing authority, certifying authority and audit authority. As from 2010, the Commission has intensified its audit efforts in this Member State. 13 audit missions were carried out in 2010; in the first half of 2011 8 missions have been carried out, while 14 further missions are planned. In its 2010 AAR, DG Regional Policy has issued a reservation concerning 15 Italian programmes, and on 1 July 2011, payments to five Italian programmes

³¹ See corrective and remedial measures described in the annual activity reports for cohesion policy services for all Member States and programmes for which reservations were made in 2009 and 2010.

were stopped (payments for 3 programmes interrupted by using the new legal tool, payment to one programme interrupted while legal proceedings are on going in view of a Commission suspension decision and for one programme payments can not be made due to the absence of a compliance assessment).

In addition to the regular meetings, DG Regional Policy keeps more frequent contacts with the Italian audit authorities, most recently in September 2011. Important topics in these meetings include treatments of errors and reporting to the Commission of audit results, as well as ensuring a proper implementation of the audit strategy and audit plan. A number of bilateral meetings took place in September with the most critical programmes to discuss implementation issues and audit findings. DG Regional Policy is organising in co-operation with DG MARKT, a seminar on public procurement in the end of October.

In April 2011 Commissioner Hahn met and wrote to the Presidents of the Regions where effective implementation is particularly at risk. In parallel, DG Regional Policy is participating with the Italian central coordinating authorities in the preparation and implementation of a restructuring and acceleration plan for the Italian programmes.

In **Spain**, ERDF and CF are delivered through 23 programmes, for a total allocation of about EUR 28 billion. These are governed by a central managing authority, one central certifying authority and one audit authority. The principal tasks of the managing authority have been delegated to 145 intermediate bodies, some of those involved in more than one programme. The audit authority also delegates the regional component of the audit work of regional programmes to 19 regional audit bodies. The management and control system is complex and this may lead in practice to an unclear division of responsibilities as well as a lack of effective supervision on the part of the managing authority.

In its 2010 AAR, DG Regional Policy has issued a reservation concerning 22 programmes, but these are in fact linked to serious deficiencies in the management and control system of 13 intermediate bodies which operate in all operational programmes. The main deficiencies refer to inadequate management verifications by these intermediate bodies and public procurement issues. On 1 July 2011, parts of payments to 19 Spanish programmes were stopped (payments to eight programmes interrupted by using the new legal tool and preventive, warning letters sent for eleven programmes to the Member State to prevent the certifying authority to declare expenditure as long as the detected weaknesses were not corrected).

DG Regional Policy is making additional efforts to assist the audit authority and regional control bodies in Spain to disseminate good practice to all programme authorities and address specific shortcomings. It has provided the audit authority with comments to their internal guidance notes on the treatment of errors and numerous seminars have been held on the requirements of the 2007-2013 delivery system of Structural Funds. In addition to the regular meetings, specific meetings take place with representatives of the audit authority on technical questions.

DG Regional Policy also seeks to address some systemic weaknesses in order to prevent irregularities in future. Audits made recommendations for a number of concrete, remedial actions at central level, including:

- actions to increase the corrective capacity of the managing authority by enhancing the effectiveness of management verifications;

- actions to strengthen supervision and quality control of the work performed by the intermediate bodies.

DG Regional Policy is closely monitoring and following up with national/regional authorities – through ad hoc meetings, monitoring committees and annual examination and control meetings - to ensure that all remedial actions following audit reports, interruptions or suspensions, including financial corrections are taken. In one specific case (Valencia), Commissioner Hahn has sent a letter to the President of the regional government to express concern on some key issues.

ESF

Since 2007, Spain and Italy represent approximately 60% of the number of ESF programmes in reservation (see Annex II). In its 2010 Annual Activity report, DG Employment, Social Affairs and Inclusion has analysed the main reasons behind the problems in these Member States. Based on this analysis, a pilot programme with the Spanish authorities was initiated in March 2011 in order to identify the root causes of the problems and implement effective remedial actions. This has resulted in a number of targeted actions addressing those root causes, currently underway. Their effective implementation is closely monitored by DG Employment, Social Affairs and Inclusion in cooperation with the Spanish authorities. As part of this close monitoring and cooperation, a meeting between Commissioner Andor and the Spanish Labour Minister took place in June 2011 in order to raise awareness of the Spanish authorities at the highest level and ensure effective implementation of the agreed actions. Furthermore, a seminar is being organised by DG Employment, Social Affairs and Inclusion in October 2011 for the Spanish Managing, Certifying and Audit authorities in order to address further areas for improvement and share best practices identified. A similar approach is being developed for Italy and will be implemented in the future.

In terms of audit work on Spain, DG Employment, Social Affairs and Inclusion carried out multiple audit missions in 2010 and in the first half of 2011. As a result, in 2010 and the first half of 2011 DG Employment, Social Affairs and Inclusion has interrupted eight payments in five Spanish ESF operational programmes. On 1 July 2011, in relation to ESF operational programmes in Spain, there were seven decisions of interruption of payment or financial correction proceedings ongoing (four interruption decisions, two pre-suspension letters, one suspension decision).

Regarding Italy, DG Employment, Social Affairs and Inclusion has also intensified its audit work. Based on this work, in 2010 and first half of 2011 DG Employment, Social Affairs and Inclusion interrupted five payments on four Italian ESF operational programmes. On 1 July 2011, in relation to ESF operational programmes in Italy, there were 13 decisions of interruption of payment or financial correction proceedings ongoing (nine decisions of interruption and four pre-suspension letters).

6.3. Corrective actions

The 2010 Annual Activity Reports (AARs) of DG Regional Policy and Employment, Social Affairs and Inclusion include an action plan for each programme under reservation. This generally means that before payments can resume to the programmes under interruption, certain actions need to be taken to prevent similar problems being repeated and financial corrections need to be made to correct irregular expenditure.

Interruptions and suspensions to prevent payments to programmes where management and control systems do not function effectively are used systematically. Interruptions and suspensions are robust and effective tools to prevent payments to programmes where there are known serious risks to EU financial interests and to agree remedial actions with the Member States. DG Employment, Social affairs and Inclusion introduced in 2008 a manual of operational procedures for interruptions and suspensions of payments, in addition to existing manuals in both services. Both Directorates-General updated their existing manuals of operational procedures for interruptions and suspensions for the 2007-2013 period, with a view to further strengthen procedures and make full use of the new legal tool on interruptions. Thus the strict policy followed by Commission services on suspension of payments and financial corrections, since the 2008 Commission Action Plan, has been further strengthened in response to the 2009 discharge request for more systematic interruptions.

In April 2011, an internal interruption committee (IC) was set up by the Director-General in DG Regional Policy with a view to streamlining the internal procedure to effectively apply a strict policy to interrupt or suspend payment on the basis of the general regulation for the cohesion policy (articles 91 and 92 of Regulation (EC) N° 1083/2006). The committee meets on a weekly basis and decides to interrupt payment deadlines as soon as there is evidence to suggest a significant deficiency in the management and control system supported in an audit report. The Director-General in Employment, Social Affairs and Inclusion has on his side set up a committee for interruptions, suspensions and financial corrections and an enhanced internal monitoring to ensure the timely implementation of interruption and suspension decisions for the ESF. In addition comprehensive information on interruption and suspension decisions adopted has been included in the 2010 AARs of both Directorates-General.

DG Regional Policy had interrupted payments to 49 programmes in 2010 amounting to EUR 2.15 billion and by 1 July 2011, payments to 76 operational programmes were stopped (including payments for 40 programmes interrupted, 34 preventive, warning letters sent to programmes' authorities to prevent them from sending any payment request as long as the identified weaknesses were not corrected and 2 programmes without an approved compliance assessment).

Of these 40 programmes payment interruptions have been formally decided and three cases were in pre-suspension. For the remaining programmes, the responsible authorities received warning letters preventing them from sending payment requests to the Commission.

Overall, between 1 January 2008 and 30 June 2011, 72 interruptions of payment deadlines and 15 Commission suspension decisions were adopted for ESF Operational Programmes. On 1 July 1 2011, in relation to ESF operational programmes, there were 38 decisions of interruption of payment or financial correction proceedings ongoing (17 interruption decisions, 14 pre-suspension letters, five suspension decisions, two pre-correction letters).

Updated audit strategy 2011-2013 for Structural actions: The overall objective of the Structural Funds services' audit work is to seek reasonable assurance that the management and control systems put in place by Member States comply with requirements of the EU regulations and are functioning effectively to prevent, detect and correct errors and irregularities, ensuring thus the legality and regularity of expenditure declared to and reimbursed by the Commission.

For the 2007-2013 programming period the focus is on the reliability of the work of the audit authorities in line with the single audit concept. The audit authorities have a reinforced role

compared to the previous programming period in ensuring that the national audit strategy is well implemented and its results properly reported to the Commission.

Another important aspect of the Commission's audit strategy is to identify the riskiest programmes and Member States, and to request remedial action plans from Member States and follow-up with management.

The multi-annual audit strategy of DG Regional Policy and Employment, Social affairs and Inclusion, provides for 178 audit missions of DG Regional Policy in 2011 and in the first half of 2012 and 184 audit missions for DG Employment, Social Affairs and Inclusion in the same period. These audits focus on the following main priorities:

- Review of the work of the audit authorities, with a view to assessing whether reliance can be placed on them. The results will allow the Commission to further identify and focus on areas of risk and to provide the basis for the implementation of article 73 of Regulation (EC) N° 1083/2006, whereby it can rely on the work of the audit authorities and focus its own audits on specific / risky programmes.
- Audit of high risk programmes and themes, including financial engineering instruments. In cases where the review of the work of audit authorities has revealed deficiencies, the Commission will be carrying out complementary audits to cover these gaps.
- Audit on Member States' system for recoveries, with the objective to determine whether the programmes certifying authorities have satisfactory arrangements in place for recovering irregular amounts, keeping account for those recoveries and appropriately reporting them to the Commission.
- Follow up on requests by the European Parliament and Council, as well as follow-up of the Court's findings and DAS audits.

In addition the commission services are envisaging to carry out in 2012 an enquiry to estimate the residual risk after closure 2000-2006.

6.4. The 2014-2020 legal framework

While the 2007-13 legal framework is delivering better results in terms of assurance and the Commission continues to take measures to decrease errors during the remainder of the implementation period, the Commission has taken further steps in the legislative proposal for 2014-2020 to ensure building on the progress made in 2007-13, simplifying where possible and adding/clarifying rules where necessary.

The main features introduced in the 2014-2020 proposal with a view of further preventing errors and streamlining the delivery mechanism are outlined below.

The overall delivery systems will be improved by:

Greater responsibility and accountability by the Member States

The Commission has proposed **annual management declarations of assurance** in the triennial revision of the Financial Regulation and as part of the 2014-2020 legislative package for cohesion policy, as a tool to increase accountability and assurance provided by the management level in the Member States. Such management declarations would provide the

Commission with substantial additional assurance as to the use of EU funds by Member States. In the Commission's view management declarations, audited by an independent auditor, are more appropriate to obtain assurance from Member States than the present national declarations, and would reinforce cooperation with Member States in the implementation of the budget. The **development and investment partnership contracts** between Member States and the Commission as proposed in the 2014-2020 legislative framework for cohesion policy will outline the preconditions for successful implementation of cohesion policy including strengthening of administrative capacity where necessary.

In line with the proposal of the Commission for the review of the Financial Regulation, the framework for cohesion policy will also provide for an **accreditation of bodies at national level**, which can be put on probation or withdrawn whenever necessary, placing more responsibility for the compliance of management and control systems on the Member States. While it is important to clarify that the responsibility for these systems rests with the Member States, it is proposed that a proportional risk based examination by the Commission is retained. This examination would be done ex-post and for programmes of large financial volume or of high risk, after the national decision of accreditation, to ascertain that the decision has been made on appropriate grounds.

A risk-based audit framework with greater confidence in those Member States that are continuously performing well

The concept of a contract of confidence was first introduced as an option during the 2000-2006 programming period. The Commission services signed such agreements with nine audit bodies. It was further developed for the 2007-2013 period and became enshrined in the legislative framework. Article 73 of Regulation 1083/2006 allows for an approach based on risk analysis where the Commission can rely on the work of those audit authorities that have proven the necessary level of quality in their work for operational programmes with reasonable assurance. This would result in scarce audit resources both at Member State and at Commission level being targeted towards those Member States' programmes that need greater focus.

In its legislative proposals for the 2014-2020 period, the Commission continues with this approach. For Member States with strong, independent, well-functioning audit authorities, the Commission will not audit operations, albeit it may do so, if risk assessment reveals specific risks or irregularities and fraud or for re-performance purposes. This would allow the full implementation of a **risk-based audit** methodology, efficient and targeted use of Commission resources and the **single audit approach**

The request for Member States to design anti-fraud measures proportionate to the risk identified will also further implement the Commission Anti-Fraud Strategy, based on improved awareness of fraud risks at all levels.

Streamlining the number of authorities involved

The 2014-2020 legislation also proposes an option of merging and **decreasing the number of authorities** in the Member States. A smaller number of bodies in place would reduce the administrative burden and enhance the possibility for building stronger administrative capacity, but also enable to assign clearer responsibilities.

The Commission continues taking corrective action

[Interruptions and suspensions as well as financial corrections for irregular expenditures will continue also in the 2014-2020 period, enabling the Commission to use corrective tools, where necessary. The deadline for interruptions is proposed to be increased from 6 months to

9 months to give the programme authorities more time to respond to the causes of the interruption. Where irregularities are detected by the Commission or by the Court during annual closure and in the three following years, the resulting financial corrections made would be net corrections, i.e. Member States would not have the possibility to replace the irregular expenditure anymore. Financial corrections will be facilitated by the payment of 90% of each interim payment claim of the Member State (10% will be retained until annual clearance of accounts).]

In specific areas prone to errors the following improvements are foreseen:

Eligibility:

- A wider use of simplified costs which can reduce errors related to financial management and accounting, and reorient both implementation and control on performance of operations,
- a greater thematic concentration of funding, which can entail a reduction of errors stemming from the wide variety of interventions,
- clarified rules for the benefit of the managing authority for selection of projects,
- a more simple approach to revenue-generating operations will reduce the risk of errors in determining and monitoring the revenue generated by operations,
- harmonisation, clarification and simplification of eligibility rules with other EU financial support instruments will reduce mistakes of financial recipients who use assistance from different sources.

Audit trail:

- electronic data management and electronic data exchange between the administration and beneficiaries which has the potential to curtail the error rate arising from inadequate document retention, and
- annual closure, which decreases audit trail errors by shortening the time period for document retention and avoids the a substantial build-up of administrative workload linked to the one-off closure at the end of the programming period.

7. CONCLUSION

Analysis of the results of audits by the Court over the last years presented in this paper demonstrates that non-compliance with eligibility criteria together with errors in public procurement rules or procedures are the most common types of errors detected in cohesion policy. Also inadequate audit trail and the incorrect calculation of the co-financing rate for revenue generating projects are sources for errors. The analysis carried out shows that selection of projects and ineligible costs are the main eligibility errors, while in public procurement the main sources are assessment of bids, use of inappropriate tendering procedures and publication issues.

While some errors stem from breaches of Structural Funds rules, other errors are related to breaches of EU regulations and directives which are not specific to the regulatory framework of cohesion policy (notably public procurement rules).

While the analysis presented in this paper is subject to limitations, it is helpful in identifying the main sources of errors. Thus it provides good ground for outlining actions in response to the errors, both for the 2007-13 and the next programming period.

The geographical analysis has pointed to specific programmes in a limited number of Member States, while the vast majority of programmes in most Member States provide increased assurance in the 2007-13 period.

This analysis also shows that the results of the Commission's supervisory work largely correspond to the Court's results in terms of identifying the nature of errors.

The Commission has analysed and presented in this paper an overview of various actions taken to tackle the errors. Specific action has been taken recently concerning eligibility issues by setting up an advisory system and numerous activities are ongoing in the area of public procurement. While it will take a few years to conclude whether these measures are sufficient, the continuous implementation of a strict policy of interruptions and suspensions should help to diminish the errors in the years to come. Careful monitoring is deemed necessary to continuously assess the sufficiency of actions taken and present further ones in a timely manner. Public procurement and eligibility remain such areas.

The Commission's proposal for the 2014-2020 legislative framework includes several measures which simplify and help increase assurance of the delivery system for the future. The main elements of the 2014-2020 proposal with a view to reducing errors as outlined at the end of this paper, build upon the measures in place in the current programming period, but also present new ones, such as electronic data management, with a potential for further reducing errors.

Annex I: Glossary

Assurance is of confidence one has on a certain consideration. In the context of the Structural Funds and for the purpose of establishing the Annual Activity Reports, the Commission DGs seek to obtain assurance on the appropriate use of resources, in accordance with sound financial management and guaranteeing legality and regularity of transactions. The Commission assigns four levels of assurance to the operational programmes or CF projects with a view to reaching the overall level of assurance for the DG. These levels are:

Reasonable assurance: signifies that there are no material deficiencies in key elements of the systems

A qualified opinion signifies the existence of material deficiencies in key elements of the systems. Where it has been concluded that the impact is **moderate**, it means that the risk for payments is low for the year covered by this annual activity report. Where it has been concluded that the impact is **significant**, this indicates a medium risk for payments for the year covered by this annual activity report.

No assurance signifies that there are material deficiencies in key elements of the systems so that no reasonable assurance has been obtained on the functioning of those systems, and the risk for payments in the year covered by this annual activity report is high.

Source: Annex 4 of DG Regional Policy AAR for 2010.

Audit sampling involves testing less than 100% of items selected from a population while seeking to draw conclusions about the whole population. Given that auditors have seldom the opportunity to review the totality of information/transactions in question, audit sampling is a widely used audit technique. A sample may be statistical or non-statistical. A **statistical sample** requires the use of random selection methods and uses probability theory for determining the sample and for evaluating the results in a quantitative manner. Random selection methods can be used in **non-statistical sampling**, which increases the likelihood that the sample is representative of the population. A sample is **representative** when it reflects the characteristics of the population.

Source: European Implementing Guidelines for the INTOSAI auditing standards, guideline N°23, Audit Sampling.

<http://eca.europa.eu/portal/pls/portal/docs/1/133817.PDF>

Audit trail is a record or system that allows tracing declared expenditure to the supporting documents at all levels, from beneficiary to the European Commission. The requirements for an adequate audit trail are defined in Article 15 of Regulation (EC) N° 1828/2006. It should permit the reconciliation of aggregate amounts certified to the Commission with detailed records and supporting documents held at all levels.

Error - transactions (or parts thereof) and/ or actions linked to them which have not been carried out in accordance with the legal and regulatory provisions applicable.

Source: ECA brochure "The DAS methodology": <http://eca.europa.eu/portal/pls/portal/docs/1/1671539.PDF>

Error rate – an indicator which provides an estimation of the overall impact for the entire population of payments made within a financial year and is based on the audit of a representative sample of transactions.

Source: Court of Auditors Annual Report for 2009, Annex 1.1, point 11

The **most likely rate of error** (MLE) is the weighted average of the percentage error rates found in the audited sample. With the use of sampling techniques and for a certain level of confidence (usually 95%), a range within which the rate of error for the population lies can also be calculated. This range is between the **lower error limit** (LEL) and the **upper error limit** (UEL).

Financial correction – a financial correction made by the Commission or by the Member State consists of cancelling all or part of the public contribution to an operational programme, which does not meet the conditions of funding because of irregularity. The purpose of financial corrections is to restore a situation where 100% of the expenditure declared for co-financing from the Structural Funds is in line with the applicable national and EU rules and regulations.

Source: Commission Decision C(2001)476 of 2 March 2001 and Article 98 of Regulation (EC) N° 1083/2006.

Fraud, in respect of expenditure, is any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Union or budgets managed by, or on behalf of, the European Union;
- non-disclosure of information in violation of a specific obligation, with the same effect;
- the misapplication of such funds for purposes other than those for which they were originally granted.

Source: Convention drawn up on the basis of Article K.3 of the Treaty on European Union, on the protection of the European Communities' financial interests, OJ C 316 , 27/11/1995, p. 49

Frequency of error – an indicator which shows the proportion of transactions in the sample affected by errors (both quantifiable and non-quantifiable). This indicates how widespread errors are likely to be within a policy group as a whole.

Source: Court of Auditors Annual Report for 2009, Annex 1.1, point 10

Irregularity - any infringement of a provision of [EU](#) law resulting from an act or omission by an economic operator which has, or would have, the effect of prejudicing the general budget of the European Union by charging an unjustified item of expenditure to the general budget

Source: [Article 2, 7\) of Council Regulation \(EC\) N ° 1083/2006](#)

Materiality level - In general terms, a matter may be judged material if knowledge of it would be likely to influence the user of the financial statements or the performance audit report.

Materiality is often considered in terms of value but the inherent nature or characteristics of an item or group of items may also render a matter material--for example, where the law or some other regulation requires it to be disclosed separately regardless of the amount involved. In addition to materiality by value and by nature, a matter may be material because of the context in which it occurs. For example, considering an item in relation to the overall view given by the accounts; the total of which it forms a part; associated terms; the corresponding amount in previous years. Audit evidence plays an important part in the auditor's decision concerning the selection of issues and areas for audit and the nature, timing and extent of audit tests and procedures.

Source: INTOSAI code of ethics and auditing standards: <http://intosai.connexcc-hosting.net/blueline/upload/1codethaudstande.pdf>

Non-quantifiable error – an error in the event when it *is not* possible to measure how much of the amount paid is affected by the error.

Quantifiable error - errors which have a direct and measurable financial impact on the amount of the underlying transactions financed from the Community budget.

Source: ECA brochure "Definition and treatment of DAS errors": <http://eca.europa.eu/portal/pls/portal/docs/1/1321566.PDF>

Retrospective projects – There is no published definition of retrospective projects. In the context of Structural Funds, retrospection refers to the award by a managing authority of an EU grant to an operation / project which has already incurred significant expenditure or indeed is already complete before the grant is formally awarded. Such projects have normally received funding from national funds. Even though the regulations do not explicitly interdict retrospective projects, there is a specific high risk of non compliance with Structural Funds rules, where operations were initiated or carried out without consideration of specific requirements. Requirements not respected may relate to the eligibility period, respect of the selection criteria, the respect of publicity rules, timely management verifications carried out during implementation and respect of public procurement requirements.

Annex II : Reservations in the Annual Activity Reports of DGs Regional Policy and Employment, Social Affairs and Inclusion 2007-2010

Over the last four years Directorates-General Regional policy and Employment, Social Affairs and Inclusion made reservations for operational programmes from the 2000-2006 and 2007-2013 programming periods in the following Member States³²:

DG Regional Policy AAR (ERDF)³³	2007⁽¹⁾	2008⁽¹⁾	2009	2010
Belgium		5		
Bulgaria			2 ⁽²⁾	3
Czech Republic	4			5
Finland	4			
Germany	4	2	8	6
Greece	15 (11%)			1
Ireland	4			
Italy	17 (13%)	12 (23%)	15 (19%)	15 (16%)
Latvia				3
Lithuania				1 ⁽³⁾
Luxembourg	1			
Netherlands				1
Poland	3			
Romania				2
Slovakia	2			
Spain	31 (23%) ⁽⁴⁾	13 (25%) ⁽⁵⁾	23 (29%)	22 (23%) ⁽⁶⁾
UK			1	9
Interreg / ETC	51 (38%)	21 (40%)	30 (38%)	9/19 (29%)
Total of OPs in reservation	136 (100%)	53 (100%)	79 (100%)	96 (100%)

(1) No reservations for 2007-2013 period

(2) Partial reservation

(3) Partial reservation: 1 intermediate body (IB) in 1 operational programme (OP)

(4) Partial reservation: 14 IBs with an impact on 20 OPs.

(5) Partial reservation: 11 IBs with an impact on 13 OPs

³² This does not include the number of programmes per programming period and Member State. For details refer to the concerned annual activity reports.

³³ The reservations for Cohesion Fund projects are not included in the table

(6) Partial reservation: 13 IBs with an impact on 21 programmes

DG Employment AAR (ESF)	2007	2008	2009	2010
Spain	27 (41%)	18 (38%)	26 (44%)	15 (35%)
Italy	13 (20%)	12 (25%)	10 (17%)	11 (26%)
France	9	7	5	4
Belgium	3	5	6	1
Germany	0	1	9	4
U.K	8	3	0	2
Austria				2
Bulgaria				1
Ireland				1
Luxembourg	2	2	1	
Portugal	1			
Romania			2	
Slovakia	3			2
Total of OPs in reservation	66 (100%)	48 (100%)	59 (100%)	43 (100%)

Annex III: Examples of errors

Eligibility errors

Selection of projects –

A specific case of errors in the selection process is related to the so called "retrospective projects". Such are projects which are finalised with the use of national funds and inserted in an operational programme at a later stage, usually in order to avoid the loss of funds under the N+2 rule. Even though the regulations do not explicitly interdict retrospective projects, these are more prone to errors, such as not respect of publicity rules, limited possibility of management verifications during implementation and respect of public procurement requirements. As an example, an ERDF project supported the construction of three equalisation towers on a water pipeline distributing water from a local dam. It was implemented during 2000–2004. The pipeline was never used because the dam was never filled with water. Although the managing authority knew that the project could not attain the specific objectives set and that it was thus ineligible, it decided to include it into the operational programme to replace another project rejected by the Commission.

Ineligible costs – In one ERDF project, the declared expenditure consisted only of purchase of land. However, according to the ERDF eligibility rules, land purchase may not represent more than 10 % of the total eligible expenditure. In spite of this, the managing authority had approved the project for reimbursement.

Public procurement:

Absence of tendering or award of contract based on inappropriate tendering procedure and award of supplementary contracts without competition.

In the case of a CF project the procurement of services related to the administrative preparation and technical planning for an infrastructure project was carried out by negotiated procedure. The Court's audit showed however that the conditions which have to be in place so that a negotiated procedure can be used were not fulfilled.

Unlawful selection criteria

In the tendering of two contracts in an ERDF project, a formula of average prices was used in the evaluation of the financial offers. This formula penalises the lowest offers without giving the bidder the option to justify it.

According to the judgment of the European Court of Justice (Case SECAP SpA, C-147/06), the above mentioned practice is discriminatory.

Furthermore, with this practice the offer selected may not be the one with the lowest price, which would in certain cases be in contradiction with Council Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts³⁴, notably in the determination of the economically most advantageous tender.

Examples of ESF errors

³⁴ OJ L 199, 9.8.1993, p. 54.

Over-declaration of expenditure: in the Annual report 2008 (par. 6.18), the Court presented an example of incorrect allocation of direct and overhead costs: expenditure needs to be related to the co-financed operations in order to be eligible. In one ESF project, the salary of an administrator, several suppliers' invoices and some equipment purchases were declared to the project although this expenditure was related also to the beneficiary's other activities. In addition, for equipment purchases only depreciation is eligible, but the whole purchase price was declared.

Overheads' issues: in the Annual report 2009 (par. 4.20) the Court presented as an example of non respect of eligibility rules an error due to over declaration of staff costs: the beneficiary incorrectly charged various indirect costs (staff salaries, fuel, telephone and depreciation) to the project supporting training courses for pupils from secondary school.

Annex IV: Applicable Regulations

The principal regulations governing cohesion policy are for the 2000-2006 period:

Regulation (EC) N° 1260/1999 (general provisions on the Structural Funds);

Regulation (EC) N° 438/2001 (on the management and control systems);

Regulation (EC) N° 448/2004 (eligibility of expenditure of operations co-financed by the Structural Funds);

Regulation (EC) N° 448/2001 (procedure for making financial corrections);

Regulation (EC) N° 1264/1999 (amending Regulation N° 1164/94 establishing a Cohesion Fund);

Regulation (EC) N° 1386/2002 (management and control systems and procedure for making financial corrections for the Cohesion Fund);

The principal regulations governing the 2007-2013 period are:

Regulation (EC) N° 1083/2006 (general provisions on ERDF, ESF and the CF);

Regulation (EC) 1828/2006 (rules for the implementation of Regulation 1083/2006);

Regulation (EC) 1080/2006 (on the European Regional Development Fund);

Regulation (EC) 1081/2006 (on the European Social Fund);

Regulation (EC) 1084/2006 (on the Cohesion Fund).

Annex IV of Regulation (EC) N° 1828/2006 sets the terms for statistical samples to be audited by programmes' audit authorities.

Other specific regulations, directives and decisions, as well as any amendments of the abovementioned regulations also apply. National laws and regulations are applicable as relevant.

