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STRUCTURAL FUNDS: DID THE COMMISSION
SUCCESSFULLY DEAL WITH DEFICIENCIES
IDENTIFIED IN THE MEMBER STATES'
MANAGEMENT AND CONTROL SYSTEMS?



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(pursuant to Article 287(4), second subparagraph, TFEU)

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REPLY OF THE COMMISSION

GLOSSARY

Article 13 report: Annual report, established according to Article 13 of Commission Regulation (EC) No 438/2001, disclosing the results of second level checks and sent to the Commission.

Closure process: On the basis of a winding-up declaration, financial settlement of outstanding EU commitments for a programme through payment of the balance to the Member State or the issue of a debit note. Final settlement does not prejudice the Commission's right to adopt financial corrections at a later stage.

Corrective actions: Actions requested by the Commission after identification of deficiencies in management and control systems. They consist in the implementation of financial corrections with regard to expenditure already declared to the Commission and in changes in the systems to make them effective.

Error rate: The irregular expenditure found as a proportion of total expenditure checked.

European Regional Development Fund (ERDF): One of the Structural Funds which aims to reinforce economic and social cohesion by redressing the main regional imbalances through support for the development and structural adjustment of regional economies. It also supports cross-border, transnational and interregional cooperation. ERDF interventions are implemented through programmes involving a large number of projects.

European Social Fund (ESF): One of the Structural Funds which aims to strengthen economic and social cohesion by improving employment and job opportunities, encouraging a high level of employment and more and better jobs. ESF interventions are implemented through programmes involving a large number of projects.

Financial correction: Procedure consisting in disallowing an amount of expenditure already paid by the Commission to a Member State because it was found irregular. When Member States make such corrections themselves, they may substitute the irregular amounts with other eligible expenditure. If the Member State fails to make them, the Commission may apply financial corrections itself. In such cases, irregular expenditure may not be substituted by other eligible expenditure, leading to a net reduction in the Structural Funds contribution.

First level checks (Article 4 checks in the regulation): Procedures carried out by the body in charge of the management of a programme according to Article 4 of Commission Regulation (EC) No 438/2001. The aim is to verify the reality of expenditure claimed and to ensure compliance with applicable national and EU rules. These rules concern in particular the eligibility of expenditure under the programme concerned, public procurement and state aid. The first level checks are part of the management and control systems.

Irregular expenditure: Expenditure that is ineligible as not complying with EU and/or national rules or that is overstated.

Management and control systems: Systems put in place to manage and control the assistance granted under the Structural Funds that is administered by the Member States. They should ensure the sound financial management of the Structural Funds and provide adequate assurance of the correctness, regularity and eligibility of the expenditure declarations presented to the Commission.

Managing authority: Authority designated by the Member State to manage a programme. It may decide to delegate tasks to so-called intermediate bodies.

Operational programme and single programming document, called ‘programmes’ in the report: Documents prepared at central or regional level in a Member State and approved by the Commission, which should take the form of a coherent set of priorities comprising measures. The projects to be co-financed by the Structural Funds must fall within the scope of a measure. A Community support framework (strategy and priorities for action of the Structural Funds and the Member State to be implemented through various programmes) and an operational programme can be merged to take the form of a ‘single programming document’. A budget is established for each programme and is made up of national, regional and local public funds on the one hand and the Structural Funds co-financing on the other hand.

Paying authority: Authority designated by the Member State for the purposes of drawing up and submitting payment applications and receiving payments from the Commission.

Programming period: Multiannual framework within which Structural Funds expenditure is planned and implemented, such as the period 2000–06.

Second level checks (sample checks or Article 10 checks in the regulations): Checks carried out by a body independent of the managing and paying authority according to Article 10 of Commission Regulation (EC) No 438/2001. The aim is to verify the effectiveness of the management and control systems in place and, selectively, expenditure declarations made at the various levels. The checks are carried out on the basis of a representative sample of the projects approved. They have to cover at least 5 % of the total eligible expenditure already declared to the Commission and to be equally spread over the programming period. The results of these checks are reported to the Commission in annual reports (the Article 13 reports) and are the basis for the winding-up declaration of a programme. The second level checks are part of the management and control systems.

Structural Funds: The EU’s principal policy instrument in support of the Treaty objectives of economic and social cohesion. ERDF and ESF are the two Structural Funds.

Winding-up body: Body issuing the winding-up declaration at the end of the programming period. It can be the same as the body carrying out the second level checks.

Winding-up declaration: Opinion provided by the winding-up body on the validity of the final request for payment and the final certificate of expenditure presented for a programme co-financed by Structural Funds. Important management and control weaknesses or a high frequency of irregularities should lead to a negative opinion. In case of a high frequency of irregularities, the opinion shall refer to these circumstances and shall estimate the extent of the problem and its financial impact.

EXECUTIVE SUMMARY

I.

When significant deficiencies are identified in the Member States' management and control systems, the Commission's objective is to ensure that past irregularities are corrected and that systems are improved for the future. To do so, the Commission can:

- (a) request the Member States to implement financial corrections. Where a Member State does not agree, the Commission can impose a financial correction;
- (b) request the Member States to implement corrective actions so that the expenditure still to be declared is processed by effective systems able to prevent or otherwise detect and correct irregularities;
- (c) suspend payments until appropriate corrections are carried out.

II.

The Court's audit was mainly carried out on the basis of a review of 40 programmes in which significant deficiencies had been identified. It aimed at assessing whether the Commission dealt in a satisfactory way with deficiencies identified in the Member States' management and control systems and in particular whether:

- (a) the Commission initiated appropriate corrective actions;
- (b) the Commission ensured the timeliness of their implementation;
- (c) the Commission had sufficient assurance that its actions led to appropriate financial corrections in respect of past irregularities and to improvements in the systems to prevent the recurrence of irregularities.

EXECUTIVE SUMMARY

III.

Overall the Court concluded that:

- (a) the Commission generally takes the appropriate actions when deficiencies in management and control systems are identified but the process until implementation is lengthy;
- (b) the Commission had some success in ensuring that financial corrections were correctly applied;
- (c) the Commission obtained varying degrees of assurance that its actions led to improvements in national management and control systems;
- (d) the Member State authorities were able to replace ineligible expenditure disallowed by new expenditure and to have a buffer to compensate for further financial corrections.

IV.

The Court recommends that:

- (a) as far as the implementation of corrective actions is concerned the Commission should:
 - reduce the duration of the administrative procedure from identification of deficiencies until implementation of corrective actions;
 - give higher priority to its audit work on the audit authorities to ensure that they produce robust error rates so that financial corrections can be applied on the basis of these error rates;
 - disseminate checklists that serve as best practice to be followed by the Member State authorities for their first level checks;
 - ensure that financial corrections implemented before closure cover all expenditure incurred under deficient management and control systems;
- (b) as far as the substitution of ineligible expenditure is concerned the Commission, the Council and the European Parliament should:
 - reconsider when discussing future plans for spending on cohesion whether any changes should be made to the arrangements regarding the possibilities for substitution of expenditure found to be ineligible, in order to enhance the added value of European funds.

INTRODUCTION

STRUCTURAL FUNDS

1. Structural Funds represent about one third of the EU budget. **Table 1** shows the financial resources dedicated to the main funds for the 2000–06 and 2007–13 programming periods (as at 3 January 2012).
2. Management of Structural Funds expenditure is shared between the Commission and the Member States¹: Member States prepare multi-annual programmes which are assessed and approved by the Commission and later implemented by the Member States. The Commission has to ensure that Member States have smoothly functioning management and control systems so that EU funds are efficiently and correctly used. The Commission bears the ultimate responsibility for the implementation of the EU budget².

¹ At the Commission, the European Regional Development Fund is managed by the the Directorate-General for Regional Policy (Regional Policy DG) and the European Social Fund by the Directorate-General for Employment, Social Affairs and Inclusion (Employment, Social Affairs and Inclusion DG).

² Articles 17(1) TEU and 317 TFEU.

TABLE 1

FINANCIAL RESOURCES FOR THE STRUCTURAL FUNDS

(billion euro)

	2000–06		2007–13	
	Total allocation ¹	Amount paid to Member States	Total allocation ¹	Amount paid to Member States
European Regional Development Fund (ERDF)	129,6	124,3	200,3	68,7
European Social Fund (ESF)	68,5	64,5	76,6	27,1

¹ Financial resources made available to the ERDF and the ESF in the financial framework for the period concerned. This framework is a multiannual spending plan that translates into financial terms the EU's policy priorities.

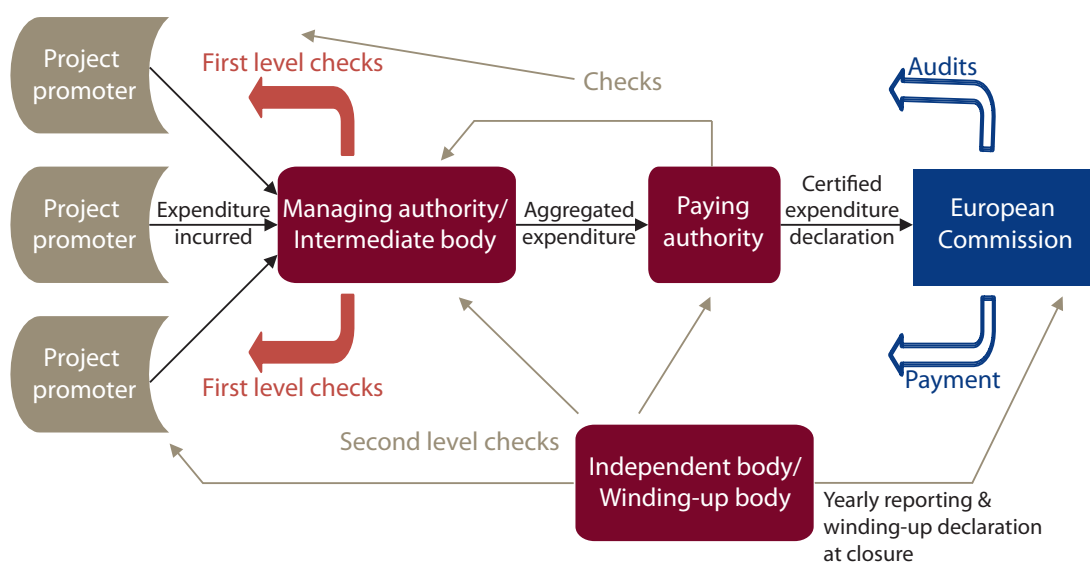
Source: Commission database InfoView.

3. The management and control system for the 2000–06 period is illustrated in the **Figure** and described in the paragraphs below. The set-up for the 2007–13 period aimed at reinforcing this system³. Where differences are important in the framework of this report, they will be mentioned in the relevant section.

³ The responsibilities of the Commission and the Member States with regard to the 2000–06 programming period were mainly defined in Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds (OJ L 161, 26.6.1999, p. 1) and in 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 63, 3.3.2001, p. 21). With regard to the 2007–13 period, the responsibilities are mainly defined in Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999 (OJ L 210, 31.7.2006, p. 25) and Commission Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund (OJ L 371, 27.12.2006, p. 1).

FIGURE

MANAGEMENT AND CONTROL OF A STRUCTURAL FUNDS PROGRAMME



4. Individual projects proposed by promoters⁴ are appraised and approved by the managing authority of the programme or under its authority by intermediate bodies. The expenditure incurred during project implementation is reported at regular intervals to the managing authority, which is also responsible for carrying out first level checks. These checks are done to ensure the legality and regularity of expenditure.
5. The expenditure incurred by the various project promoters is then aggregated and forwarded to the paying authority, which is responsible for certifying expenditure declarations sent to the Commission. The paying authority has to make sure that the managing authority has adequately fulfilled its tasks and that the statement of expenditure only includes legal and regular expenditure. On the basis of this certified expenditure declaration the Commission pays the Structural Funds co-financing⁵ amount to the Member States.
6. A body, which must be independent of the managing and the paying authorities, is responsible for carrying out second level checks designed to verify the effectiveness of the systems in place and the expenditure declarations made at the various levels. The results, which particularly towards the end of the 2000–06 period often included error rates for expenditure checked, are reported yearly to the Commission in the so-called annual Article 13 reports⁶.
7. After the programming period, the programmes enter the closure process where the Commission and the Member States finally settle the accounts. This process starts with the submission to the Commission of the closure documents for the programmes, not later than 15 months after the end of the programming period⁷. They include a winding-up declaration in which the winding-up body, which can be the same as the independent body, has to provide an opinion on the legality and regularity of the expenditure included in the certified statement of final expenditure. The main building block for this opinion is the error rate as established at the level of a programme by the second level checks that were carried out during the programming period by the independent body.

⁴ Promoters can be public or private bodies and persons. Example of a public promoter: a road administration implementing the construction of a new highway. Example of a private promoter: a private company that intends to rationalise its production process by the purchase of new machinery.

⁵ The budget allocated to a programme is financed by public funds of the Member State, private funds and Structural Funds.

⁶ The reports take this name as they are required under Article 13 of Regulation (EC) No 438/2001.

⁷ For the 2000–06 programming period, expenditure was eligible for most programmes from the moment the Commission received the request for approval of the programme (mostly 1 January 2000) until 30 June 2009. The closure process started with the submission of the documents 15 months after this deadline, that is on 30 September 2010. However, for some programmes, the process started earlier as 31 December 2008 was set as the end date for eligibility while for the Greek programmes it started later as they benefited from an extension of the end date for eligibility up to 31 December 2009.

SYSTEM DEFICIENCIES AND CORRECTIVE ACTIONS

8. The requirements with regard to the control systems in the Member States (such as bodies to be nominated and checks to be carried out) were defined for the first time in the middle of the 1994–99 programming period⁸. They were further developed in the regulations for the following programming periods.
9. Systems are effective when they prevent or otherwise detect and correct irregular expenditure. The key elements in the systems for the 2000–06 period are the first- and second level checks⁹:
 - (a) the first level checks have to be done before expenditure is declared to the Commission and have to cover all expenditure declarations submitted by a project promoter unless there is justification to do it on a sample basis;
 - (b) the second level checks have to cover both the systems in place as well as expenditure declared for projects. Checks on projects have to be done on a sample covering a minimum of 5 % of the expenditure already declared to the Commission but do not need to be carried out on a statistically representative sample. The irregular expenditure found in the sample as a proportion of the total expenditure checked is the error rate.
10. When these checks are deficient, the risk of declaring and paying for irregular expenditure is high. This is confirmed by the continuously high error rates identified by the Court in its yearly audits of the programming period 2000–06. Examples of system deficiencies and errors are given in **Box 1**.
11. Deficiencies in the management and control systems are identified by the Commission on the basis of its own audits, of audits of the European Court of Auditors or audits and checks of Member State authorities (such as disclosed in the Article 13 reports). The Employment, Social Affairs and Inclusion DG and the Regional Policy DG provide their assessment on the effectiveness of the systems for each approved programme in their annual activity reports.

⁸ Regarding the 1994–99 programming period, see Commission Regulation (EC) No 2064/97 of 15 October 1997 establishing detailed arrangements for the implementation of Council Regulation (EEC) No 4253/88 as regards the financial control by Member States of operations co-financed by the Structural Funds (OJ L 290, 23.10.1997, p. 1). This regulation was repealed by Regulation (EC) No 438/2001 which applied for the 2000–06 period.

⁹ The checks carried out by the paying authorities (see paragraph 5) were not considered as part of the key elements as they were rarely of a nature to compensate for deficient first and second level checks. They also were rarely the subject of extensive corrective actions.

12. Once the deficiencies are identified, the following courses of action are available to the Commission¹⁰:

- (a) to suspend payments until deficiencies are remedied, after sending a so-called pre-suspension letter requesting the Member State authorities to submit their comments;
- (b) to request the Member States to implement corrective actions. Depending on the source of identification of the deficiencies, the Commission's request takes the form of recommendations either in its audit reports or in letters referring to observations in reports from other authorities. They can be complemented by separately agreed action plans.

¹⁰ See Articles 38 and 39 of Regulation (EC) No 1260/1999.

BOX 1

EXAMPLES OF SYSTEM DEFICIENCIES AND ERRORS

Low coverage of expenditure by first level checks or insufficient quality of the first level checks increase the risk of non-detection of irregular expenditure such as:

- ineligible expenditure: for example, if the expenditure declared concerning a project not located in an eligible area is detected in an audit, this irregularity will result in a 100 % error rate; or
- expenditure not actually incurred or not documented: for example, if staff costs are declared for four persons working on a project and an audit detects that one person was not actually part of the project, the irregularity will result in a 25 % error rate.

13. The Commission's objective is to achieve a situation where expenditure is legal and regular and to improve future management (see examples in **Box 2**):

- (a) regarding expenditure already incurred and reimbursed by the Commission: the Member State authorities are requested to assess the extent of irregularities and to apply financial corrections as a consequence. Where a Member State agrees to make a correction, the EU funding that is released can be reused for other eligible expenditure under the programme concerned¹¹. If a Member State does not agree to implement a correction, the Commission can make the financial corrections itself. When the correction is made by the Commission, EU funds are lost for the Member State concerned;
- (b) regarding expenditure still to be declared to the Commission: the Member State authorities are requested to implement changes in the management and control systems to make them effective.

¹¹ Article 39(1) of Regulation (EC) No 1260/1999.

BOX 2

EXAMPLES OF ACTIONS REQUESTED BY THE COMMISSION TO CORRECT DEFICIENCIES

Following audits it had carried out in a Member State, the Commission requested the implementation of an action plan which concerned three programmes and dealt with public procurement¹². It included the following actions:

- o to carry out, on a statistical sampling basis, a retrospective verification of public procurement contracts for which expenditure had been declared and to quantify the financial impact of the errors found;
- o to revise the methodology for checking the legality of public procurement procedures and send a description to the Commission.

In another case, inadequate first level checks were found by the Commission during an audit. It requested the national authorities:

- o to increase the number of expenditure items to be checked;
- o to ensure that the eligibility rules were verified in the first level checks (a sufficient level of detail should appear in the checklist used).

¹² There are European directives which set out the rules to be followed for public works, services and supplies contracts if the initial budget for these contracts exceeds the ceilings defined in the directives. The directives of the European Parliament and of the European Council currently in force (and transposed into law at the level of the Member States) are Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors (OJ L 134, 30.4.2004, p. 1) and Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (OJ L 134, 30.4.2004, p. 114). For contracts that are not subject to the provisions of the directives (budget not exceeding the ceiling), there may be specific provisions in national or regional laws.

14. Once the Commission has sufficient and reliable evidence of the successful implementation of the actions requested, it can close the actions and/or lift the suspensions and restart payments for the expenditure declarations received.
15. The Commission's last opportunity to deal with system deficiencies is during the closure process that is currently ongoing for the 2000–06 programming period. The Commission does quality checks to obtain assurance *inter alia* on the validity of the error rate presented in the winding-up declaration. Where the final error rate validated by the Commission exceeds 2 %, the Commission will impose financial corrections on an extrapolated basis. Irregular amounts are corrected individually when error rates are below 2 %.
16. In 2008, following the Court's annual report of 2006, the Commission adopted an action plan¹³ to strengthen its supervision of Member States. The objective was to address the high level of errors in reimbursements for structural actions and weaknesses in the Member States' systems. Two years later, in February 2010¹⁴, the Commission concluded that the first audits of the 2007–13 programmes indicated positive results and the numerous preventive actions taken for closure, including financial corrections, provided expectations that at closure the overall risk of error would be substantially lower, reducing the risk of loss to the EU budget¹⁵.

¹³ 'An action plan to strengthen the Commission's supervisory role under shared management of structural actions', COM(2008) 97 final of 19 February 2008. This action plan, which concerns the Commission itself, is not to be confused with a type of corrective action, also called 'remedial action plan', requested by the Commission and to be implemented in the Member States (see paragraph 12).

¹⁴ 'Impact of the action plan to strengthen the Commission's supervisory role under shared management of structural actions', COM(2010) 52 final of 18 February 2010.

¹⁵ According to the annual accounts of the European Union for the year 2010, the total amount of financial corrections confirmed for the period 2000–06 is 4 165 million euro for ERDF and 1 174 million euro for the ESF. The total amount of financial corrections reported for the period 1994–99 is 1 758 million euro for the ERDF and 397 million euro for the ESF.

AUDIT SCOPE AND APPROACH

17. The audit assessed whether the Commission dealt successfully with deficiencies identified in the Member States' management and control systems.
18. The Court addressed the following sub-questions:
 - (a) Did the Commission initiate the appropriate corrective actions when deficiencies in the Member States' management and control systems were identified?
 - (b) Were the corrective actions implemented within a reasonable time?
 - (c) Did the Commission have sufficient assurance when it concluded that deficiencies had been remedied?
19. The audit focused on the actions taken by the Commission to correct deficiencies found mostly from 2005–06 onwards, on ERDF and ESF 2000–06 programmes.
20. The audit was based on the review of:
 - (a) the 210 programmes for which significant deficiencies had been identified by the Commission between 2006 and 2008 (see **Table 2**), in order to assess whether it took action each time deficiencies were identified;
 - (b) a random sample of 40 programmes (see the **Annex**) (23 programmes for the ERDF and 17 programmes for the ESF with a total budget allocated of 43 109 million euro) in order to assess the appropriateness of the actions taken, the time spent to implement the actions, and the degree of assurance obtained by the Commission to draw conclusions in respect of these actions. On-the-spot visits were carried out for four programmes of the sample;
 - (c) the evaluation by the Commission, in its annual activity reports (see paragraph 11) for the 2007–13 programming period, of the degree of assurance it has on the effectiveness of the management and control systems of the successor programmes of the 40 programmes sampled.

TABLE 2

POPULATION OF PROGRAMMES

	ERDF	ESF
Programmes in total ¹	223	212
Programmes for which significant deficiencies were identified by the Commission between 2006 and 2008	113	97
Programmes for which financial corrections were agreed by the Commission and Member States	110	58
Programmes for which a suspension decision was taken by the Commission	27	5

¹ This population does not include programmes for Interreg (promotion of cross-border, transnational and inter-regional cooperation), Urban (promotion of economic and social regeneration of cities and urban neighbourhoods in crisis) and Equal (promotion of the development of human resources in the context of equal opportunities). One and the same programme can include some measures co-financed by the ESF and others co-financed by the ERDF. In such cases the programme is to be found both in the ERDF and the ESF column.

Source: European Court of Auditors on the basis of Commission data.

OBSERVATIONS

DID THE COMMISSION INITIATE APPROPRIATE CORRECTIVE ACTIONS WHEN DEFICIENCIES IN THE MEMBER STATES' MANAGEMENT AND CONTROL SYSTEMS WERE IDENTIFIED?

BACKGROUND AND AUDIT CRITERIA

- 21.** In order to adequately fulfil its supervisory role, the Commission has to initiate a procedure with the responsible Member State authorities once it becomes aware of significant deficiencies in the management and control systems of a programme. The aim of this procedure is to define relevant corrective actions to be implemented by the Member State authorities so that irregular expenditure already declared is corrected and that the systems become effective.
- 22.** The Court assessed whether:
 - (a) the Commission took action each time significant deficiencies were identified;
 - (b) all significant deficiencies were addressed by appropriate corrective actions.

CORRECTIVE ACTIONS WERE SYSTEMATICALLY INITIATED

- 23.** An examination of the 210 programmes, for which significant deficiencies had been identified between 2006 and 2008, shows that the Commission took action in all cases.
- 24.** When the Commission formulated requests on the basis of information found in Article 13 reports (which was mainly the case for the Employment, Social Affairs and Inclusion DG), they were necessarily formulated in general terms as detailed information on deficiencies was not available. In the majority of cases (around 75 %) these requests based on the Article 13 reports did not lead to financial corrections.

IN 90 % OF CASES DEFICIENCIES IDENTIFIED WERE APPROPRIATELY ADDRESSED

25. For the majority of the 40 programmes reviewed by the Court, the Commission's actions to improve the systems in the Member States tackled all the deficiencies identified.
26. When it identified errors on projects which were potentially systemic in character¹⁶, the Commission requested action to be taken with regard to other expenditure that was likely to be affected. Furthermore, in some instances, the findings for one or more programmes implemented in a specific Member State led the Commission to request action on other programmes in that Member State, even though they had not been audited. An example of such an extension of a request for action is given in **Box 3**.
27. For the majority of the 40 programmes which the Court reviewed (90 %), the actions requested by the Commission were the appropriate response to the deficiencies identified. An example where the response was not complete is given in **Box 4**.

¹⁶ An error is considered as systemic when there is a high probability that the same problem may affect other projects in a similar manner. It is then necessary to identify the extent of this systemic error. Example: a project promoter has wrongly interpreted an eligibility rule. If the promoter carried out several projects, these may all be subject to the same misinterpretation and thus irregular expenditure might have been declared for all of these projects.

BOX 3

EXAMPLE OF AN EXTENSION OF A REQUEST FOR ACTION TO PROGRAMMES NOT AUDITED

Audits carried out by the Commission on two programmes in a Member State (Sardinia and Lazio) identified problems with regard to the application of public procurement rules. As these problems were considered to be of systemic nature, the Commission did not limit its request to carrying out financial corrections for the projects audited only. The Member State was requested to carry out a check on a representative sample of all contracts subject to public procurement rules and for all its programmes. On the basis of the results, financial corrections were made.

- 28.** The extent of the Commission's demands varied sometimes, in particular with regard to the implementation of the first level checks as shown by the examples in **Box 5**. While for some programmes the authorities checked 100 % of expenditure declared, for other programmes this percentage was as low as 1 %. When only a small percentage of the expenditure is covered this implies a higher risk of non-detection of irregular expenditure, which has to be tackled no later than closure.

BOX 4

EXAMPLE OF A CASE WHERE THE REQUESTED ACTIONS WERE NOT COMPLETE

An audit carried out by the Commission in 2007 for one programme (Galicia) dealt with an intermediate body and six bodies (out of 13) to whom the management was further sub-delegated. The audit revealed significant deficiencies despite the fact that the Member State authorities had carried out a number of system audits between 2003 and 2005. Although the Commission's report concluded that the intermediate body should supervise all sub-delegate bodies and should deduct all irregular expenditure, the specific recommendations concerned the audited sub-delegate bodies only. These were the most important bodies in terms of amount of funds managed (around 80 %). Nevertheless, considering the seriousness of the issues identified (first level checks not working, ineligible expenditure declared, etc.), the Commission should have requested the Member State's authorities to undertake further work to provide assurance that similar problems did not exist in respect of the non-audited bodies.

BOX 5

EXAMPLES OF MORE OR LESS STRINGENT REQUIREMENTS WITH REGARD TO FIRST LEVEL CHECKS

For the programmes in one Member State (such as Extremadura), the Commission requested a minimum check of 25 % of the expenditure which had to be increased in case a material error rate was found.

For programmes in another Member State, the Commission accepted the guidance note of the Member State authorities, which did not set any numerical requirement in terms of number of projects to be checked but specified that, for those projects checked, supporting documentation would be analysed for five cost items per cost category. For example, for the programme Merseyside, supporting documentation was checked for 1,3 % of total expenditure declared.

For another case (Saarland), the Commission did not succeed in imposing any requirement with regard to these checks.

WERE THE CORRECTIVE ACTIONS IMPLEMENTED WITHIN A REASONABLE TIME?

BACKGROUND AND AUDIT CRITERIA

- 29.** The period between identifying and remedying the deficiencies should be as short as possible so as to avoid expenditure continuing to be declared with a high risk of error or projects running into difficulties as payments are interrupted or suspended.
- 30.** The length of the phase of implementation of the corrective actions depends on:
- (a) the respect by the Member States of the deadlines set by the Commission for individual actions;
 - (b) the Commission issuing its audit reports (identification of deficiencies and follow-up audits) within the deadline set internally (3 months after the audit for the Regional Policy DG and 9 weeks for the Employment, Social Affairs and Inclusion DG) and reacting promptly to the replies from the Member State authorities (2 months).
- 31.** The Court assessed:
- (a) the time taken for closing corrective actions;
 - (b) where responsibility lay for delays incurred.

¹⁷ The calculation of the average time taken considers the point in time when the last actions were closed to be the time when the deficiencies have been remedied. However, it should be noted that often various individual actions for one programme were closed at several different points in time.

¹⁸ Rules such as those relating to public procurement and state aid are more often applicable to projects co-financed by the ERDF.

ON AVERAGE, 30 MONTHS TO IMPLEMENT CORRECTIVE ACTIONS

- 32.** The average time taken from identification of the deficiencies until all corrective actions were implemented was 30 months for the sample reviewed¹⁷. On average, the Employment, Social Affairs and Inclusion DG required less time (27 months) than the Regional Policy DG (32 months). This reflects differences in the type of projects co-financed and differences in the way the corrective actions were followed up:
- (a) the issues identified in the ERDF context generally take more time to resolve than those found in connection with the ESF because of the greater variety of projects that are eligible for co-financing and also the larger number of rules to be verified¹⁸. In addition, ERDF projects and programmes generally involve more financial resources than the ESF and thus the volume of additional work that may have to be carried out in order to remedy the deficiencies identified is larger;

- (b) the Regional Policy DG undertook follow-up audits for more cases in the sample than the Employment, Social Affairs and Inclusion DG (see paragraph 46). Such audits need to be organised, announced and the results need to be forwarded, starting a new phase of correspondence for the issues identified, if any. This time is included in the Court's calculation of time spent;
- (c) in 30 % of the programmes managed by the Employment, Social Affairs and Inclusion DG, the identification of deficiencies did not result from an audit by the Employment, Social Affairs and Inclusion DG but from reports from Member State authorities or an audit by the European Court of Auditors. That means that the time taken for the Employment, Social Affairs and Inclusion DG was reduced as it did not include the period from the end of the audit where the deficiencies were identified until the dispatch of the results.

33. The calculation of the time does not include the time necessary to implement the financial corrections once they were agreed. In the majority of cases the financial corrections agreed were implemented promptly when the next expenditure declaration was presented to the Commission. For around half of them this meant that all or part of the financial corrections had to be implemented when the final expenditure declaration was presented at the closure of the programme as it was the next declaration.

34. The Commission came to a positive conclusion in respect of the implementation of corrective actions for 87 % of the programmes reviewed by the Court. This included programmes — around 8 % of cases — where, although the file was closed, some issues were still ongoing. For the remaining 13 % of the programmes for which the process of implementation of corrective actions had been ongoing for an average of 35 months at the closure deadline, the Commission decided to handle the deficiencies during the closure process.

THE MEMBER STATE AUTHORITIES WERE PRIMARILY RESPONSIBLE FOR THE DELAYS INCURRED BUT THE COMMISSION ALSO CAUSED DELAYS ...

35. With regard to the 40 programmes reviewed, in 35 % of cases delays were mainly the responsibility of the Member States and in 39 % the responsibility was shared. In a further 5 % of cases, the responsibility lay mainly with the Commission. In 21 % of cases, there were prompt reactions from both sides.
36. Some authorities in the Member States accepted the deficiencies and agreed to take the required actions. Other authorities contested the deficiencies and only started to take action after it became clear that the Commission maintained its position (see **Box 6**).
37. The Commission was sometimes slow in forwarding the result of its audits to the Member State authorities. For 16 % of the audits carried out by the Commission on the 40 programmes, this took approximately one year while the deadline set internally by the Commission is 3 months or 9 weeks after the audit, depending on the DG (see paragraph 30 (b)).

BOX 6

EXAMPLES OF DIFFICULT COOPERATION BETWEEN THE COMMISSION AND MEMBER STATE AUTHORITIES

The Commission had identified several deficiencies in its audits of mid-2006 with regard to a number of programmes (such as Southern and Eastern Region) in one Member State (Ireland). The competent authorities in the Member State had taken the lead role in the action plan and it was difficult — sometimes impossible — for the Commission to obtain the requested information. The corrective actions were still to be finalised at closure of the programme.

For another programme (Sardinia), the Member State authorities contested the corrective actions requested by the Commission. The Commission maintained its position in several subsequent letters. It was only 20 months after the first request that the Member State authorities accepted the Commission's point of view for 25 out of 33 corrective actions.

38. With regard to the 40 programmes reviewed, a pre-suspension letter was sent in 60 % of cases, on average 16 months after the identification of the deficiencies. A suspension decision was taken in 10 % of cases. Finally, in several cases the Commission could not send such a letter or take a suspension decision anymore as there were no further payments to be made before the closure process.

39. Considering the small number of suspension decisions in the sample, it is not possible to conclude whether and to what extent such decisions would have speeded up the process.

... AND SOME ACTIONS HAVE BEEN TAKEN BY THE COMMISSION TO REDUCE THIS TIME

40. Under its action plan of 2008 (see paragraph 16), the Commission endeavoured to meet a target of 24 months from the identification of deficiencies to the conclusion of suspension/financial correction procedures. It was, however, too late for this target to have a significant impact on the average time necessary for implementing corrective actions in the 2000–06 programming period.

41. The regulation for the 2007–13 period makes it possible to interrupt payments and to decide on a financial correction without preliminary suspension proceedings. The Commission's expectation is that this will encourage Member State authorities to react rapidly when problems are identified. It is also to be noted that, as the purpose of an interruption or a suspension is to prevent any irregular payments by the Commission until corrective actions for the deficiencies identified are implemented, it is likely to have a positive impact on the annual error rates as reported by the Court.

DID THE COMMISSION HAVE SUFFICIENT ASSURANCE WHEN IT CONCLUDED THAT DEFICIENCIES HAD BEEN REMEDIED?

BACKGROUND AND AUDIT CRITERIA

- 42.** When the Commission concludes that significant deficiencies have been satisfactorily addressed (which was the case for 87 % of the sample of 40 programmes reviewed, see paragraph 34) this should be based on robust evidence concerning the corrective actions taken. These actions took the form of:
- (a) financial corrections required on the basis of an assessment of the extent of error in the expenditure already declared; and
 - (b) improvements in the systems to make them effective in preventing or otherwise identifying and correcting irregular expenditure.
- 43.** The Court examined whether the Commission:
- (a) had sufficient assurance that appropriate financial corrections had been implemented and that the systems were improved to avoid a repetition of similar errors;
 - (b) assessed that the successor programmes were free of significant deficiencies in the 2007–13 programming period.

VARIOUS WAYS FOR THE COMMISSION TO OBTAIN ASSURANCE

- 44.** The Commission has various means to obtain assurance that the corrective actions were satisfactorily implemented. The Commission can obtain assurance through carrying out follow-up audits. Otherwise, it can rely on statements/commitments made by the Member State authorities or make an assessment on the basis of supporting documentation provided by the Member State authorities. Supporting documentation may include a description of the methodology used for sample selection and additional verifications, updated checklists and reports on individual checks carried out. These methods can be combined.

45. These sources do not necessarily provide the same degree of assurance. This is demonstrated by the fact that, when the Commission used follow-up audits to check the reliability of statements made and results of checks carried out by Member State authorities, it ended with a positive conclusion in only 22 % of the cases after the first follow-up audit. In all other cases, the Commission had to ask for further corrective actions and, for some, carried out further follow-up audits.
46. The Commission has to consider the resources necessary to obtain potentially more reliable evidence: the human resources and time needed are much greater for a follow-up audit than when the assessment is based on supporting documentation or statements provided by Member States (see example in **Box 7**). As a consequence, the Commission has to perform a balancing act between the degree of assurance it wants to obtain and the degree of reliance it decides to place on Member State authorities on the basis of a risk analysis. Nevertheless, follow-up audits were carried out before concluding that corrective actions were satisfactorily implemented: this was the case for 89 % of the sampled programmes managed by the Regional Policy DG and 47 % of those for the Employment, Social Affairs and Inclusion DG.

BOX 7**EXAMPLE OF RISK INCURRED WHEN A FINDING IS CLOSED ON THE BASIS OF A COMMITMENT/STATEMENT BY A MEMBER STATE AUTHORITY**

For one programme (East of Scotland), the Commission had noted that the Article 13 reports had not provided any conclusion with regard to the systemic nature — or not — of the errors. The point was closed in 2009 on the basis of the commitment by the Member State authorities that any systemic issues would be identified. The winding-up declaration, however, did not provide any information on the nature of the errors but merely states that all systemic weaknesses identified were effectively addressed. Subsequently in 2011, the Commission carried out a closure audit including the examination of the treatment of systemic issues.

FINANCIAL CORRECTIONS ADOPTED FOR MOST PROGRAMMES ...

- 47.** The expenditure processed by deficient systems and declared to the Commission was cleared in the majority of cases by financial corrections.
- 48.** There are three types of financial corrections¹⁹:
- (a) corrections where a specific quantification is made as the extent of error is identifiable at project level (hereafter called 'quantifiable corrections');
 - (b) corrections based on extrapolation are applied when the population of projects affected by certain type(s) of errors can be identified and the error can be quantified but it is not possible to check the whole population due to the high number of projects;
 - (c) flat-rate corrections for system failures or for projects not complying with public procurement rules are applied when the impact of the error cannot be quantified.
- 49.** Corrections that are based on an extrapolation are made by applying the error rate established on a sample of projects to the whole population of projects affected by this deficiency.
- 50.** Flat-rate corrections for system failures are made by applying a percentage to the expenditure that was processed by deficient systems. They generally relate to the expenditure declared up to the moment the system deficiencies were remedied. The percentage to be applied, as determined in the guidelines of the Commission, depends on the seriousness of the deficiencies.

¹⁹ Guidelines on the principles, criteria and indicative scales to be applied by Commission departments in determining financial corrections under Article 39(3) of Regulation (EC) No 1260/1999 and, concerning public procurement, document COCOF 07/0037/03, final version of 29 November 2007.

51. With regard to the 40 programmes reviewed, **Table 3** indicates the number of programmes per type of financial correction. The financial corrections agreed concerning the Structural Funds co-financing represent around 650 million euro and further financial corrections are still in the process of being agreed. A significant part of the financial corrections was due to breaches of EU and national public procurement rules.
52. Nearly all financial corrections were made by the Member States. The EU funding released could therefore be reused for other eligible expenditure²⁰, under the programme concerned, to be declared to the Commission before the end of the programming period (see footnote 7). However, for part of the expenditure of seven programmes it was the Commission that imposed financial corrections because the Member States did not apply the financial corrections requested. As a result the funds were lost for the Member State (see paragraph 13).

²⁰ Newly declared expenditure can relate to new non-completed projects or to projects that had already been finalised and originally financed by national funds before being submitted for EU co-financing. The latter is called 'retrospective financing'. Practices with regard to the acceptance of retrospective projects vary between DGs. The Court found that these projects were more error prone than those selected in the normal way (see paragraph 6.19 of the Court's Annual Report for the year 2008).

TABLE 3

NUMBER OF PROGRAMMES PER TYPE OF FINANCIAL CORRECTION

Type of financial corrections	Number of programmes	
	Regional Policy	Employment, Social Affairs and Inclusion
Quantifiable corrections	15	13
Corrections based on extrapolation	2	4
Flat-rate corrections		
System failures	8	3
Public procurement	13 ¹	2

Note: for one and the same programme, different types of financial corrections could have been agreed, depending on the number and nature of the deficiencies.

¹ This does not include seven programmes for which flat-rate corrections for system failures were agreed which related mainly to public procurement issues.

... BUT HIGH ASSURANCE OBTAINED IN RESPECT OF THE ACCURACY OF FINANCIAL CORRECTIONS IN ONLY 67 % OF CASES ...

53. The Court considers that the Commission obtains a high degree of assurance on the accuracy of the financial corrections with regard to the deficiency identified under the following conditions:

- (a) when quantifiable corrections are applied: all projects that are subject to a deficiency are identified and the financial correction applied corresponds to the error found on the basis of a good quality check²¹ by the Member State authorities;
- (b) when an extrapolated correction is applied: the sub-population concerned by the deficiency is correctly identified²², the sample checked to assess the error rate is representative and the checks done by the Member State authorities are of good quality;
- (c) when a flat-rate correction is applied: the percentage applied corresponds to the guidelines established by the Commission.

²¹ Checks carried out on the basis of rigorously applied checklists covering all risks in a detailed manner.

²² For example:
 (i) all contracts that are subject to the application of public procurement rules or
 (ii) part of the expenditure (such as administrative/ staff expenditure) for all projects declared.

54. The assurance level of the Commission is also influenced by the type of evidence it is able to obtain with regard to the fulfillment of these conditions (see paragraphs 44 to 46). It carried out follow-up audits for 65 % of the programmes affected by financial corrections. Where the conclusion of the Commission's audit was not positive, either the Member State authorities had to do additional work which, at that stage, was very well delimited by the Commission or an agreement was reached on additional financial corrections. An example where further work was to be carried out is given in **Box 8**.

BOX 8

EXAMPLE WHERE THE FOLLOW-UP AUDIT DID NOT LEAD TO A POSITIVE CONCLUSION

For one programme (Industry and Enterprise, Czech Republic), the authorities responsible were requested to carry out a verification exercise on expenditure declared with regard to some specific issues (such as complying with public procurement rules). The Commission's follow-up audit to assess the quality of the verifications carried out concluded that these failed to detect a number of issues, or to propose adequate financial corrections for them. The authorities were thus requested to recalculate the error rates for the projects checked, taking into account the Commission's findings. This meant reviewing all the initial checks to make sure that they covered all issues not previously covered and then calculating the necessary financial correction.

55. The Court considers that in 67 % of the cases in the sample, the assurance level obtained was high. For the remaining cases (33 %) ²³ there were shortcomings reducing the assurance level.

56. One shortcoming is the full or partial lack of information regarding:

- (a) the completeness of the financial corrections implemented;
- (b) the justification of the amount of financial corrections on the basis of the deficiencies identified initially. An example is given in **Box 9**.

57. Another shortcoming relates to the scope of the checks that were actually performed: in some cases the scope was not sufficient but this was not challenged by the Commission (see examples in **Box 10**), leading to unreliable conclusions concerning the rate of error.

²³ It is to be noted that for two programmes in the sample, the Member State authorities were not requested to carry out financial corrections. They are thus not included in the calculation.

BOX 9

EXAMPLE WHERE THERE WAS INSUFFICIENT INFORMATION REGARDING THE JUSTIFICATION OF THE FINANCIAL CORRECTIONS IMPLEMENTED

For one programme (Galicia), where the intermediate body had delegated the implementation of the measures to various bodies, the Commission had requested financial corrections with regard to expenditure declared for bodies where the Article 13 reports had shown high error rates. Corrections were made with regard to four bodies, one of which on the basis of a statistical verification exercise, but the Commission did not have any information to reconcile the amount of the corrections with the error rates identified by first level checks. For three other bodies, either no or incomplete information was received. The Commission did not request further information and restarted payments.

... AND SIGNIFICANTLY LESS ASSURANCE IN RESPECT OF THE EFFECTIVE FUNCTIONING OF THE MANAGEMENT AND CONTROL SYSTEMS

- 58.** The Court considers that the Commission obtains a high degree of assurance on the effectiveness of management and control systems if the quantity and quality of the first and second level checks allow the Member State authorities to detect and correct irregular expenditure (see paragraphs 9, 10 and 28). The first level checks were a key element in the management and control systems for the 2000–06 period due to weaknesses in the legal framework regarding the requirements for second level checks (see paragraph 9).
- 59.** The Court noted that for all cases where it assessed the assurance level as high, follow-up audits had been carried out by the Commission.

BOX 10

EXAMPLES WHERE THE SCOPE TO DEFINE THE AMOUNT OF ERROR AND THUS OF FINANCIAL CORRECTIONS WAS NOT SUFFICIENT

For one programme (Transport, Italy), the Commission's audit had identified a number of potential systemic errors on the basis of a sample of projects audited. The authorities were thus required to carry out an enquiry to assess the full scope of these systemic errors and to apply financial corrections as a result. The enquiry resulted in a financial correction regarding one particular type of error only. For the other types of errors no corrections were proposed.

In a second case (Human Resources Development, Poland), the Commission had identified — for two projects of a total amount of around 214 million euro and managed by one body — a variety of errors in public contracts awarded on the basis of a specific tender procedure (accelerated procedure). A financial correction of around 25 million euro was made. However, the Commission did not request a verification on the occurrence of the various types of errors in those contracts managed by this same body which were not awarded on the basis of the accelerated procedure.

60. The Court assessed the assurance level as medium in cases where the solutions put in place regarding the systems were sufficient with the exception of some aspects of the first or second level checks. In those cases, the Commission relied mainly on the statements of Member State authorities (see example in **Box 11**).
61. The Court assessed the assurance level as low when significant aspects of the first level checks were not sufficient. These deficiencies mainly related to the quantity of checks (see paragraph 28) carried out, which were sometimes exacerbated by weaknesses in the second level checks.
62. For the programmes falling into the category 'low' the Commission had carried out follow-up audits for 64 % of cases. The majority of these audits assessed the quality of the first level checks while the quantity of these checks was not questioned.

BOX 11

EXAMPLE WHERE THE IDENTIFICATION AS WELL AS THE CLEARANCE OF DEFICIENCIES BY THE COMMISSION WAS BASED ON REPORTS FROM THE INDEPENDENT BODY

A first request for action was made by the Commission as a result of significant deficiencies regarding the first level checks for one programme (Aquitaine). The Member State authorities launched a specific verification exercise on a sample of expenditure declared in the period 2000–04. The Commission received a report on the result of the exercise showing an error rate of 2,12 %. It considered this situation to be satisfactory and did not take any further action. The Commission did not request any supporting documentation, such as filled-in checklists, and did not question the difference between this error rate and the error rate identified by the second level checks, which was much higher. A follow-up audit was not carried out. The report had not indicated the nature of the errors, in particular whether they were systemic. With regard to the improvement of the procedures from 2005 onwards, the Commission received a confirmation from the responsible authorities that the procedures covering the expenditure would be in line with the Structural Funds regulations.

A second request for action was made by the Commission less than a year after the closure of this first action as a result of the persisting high error rate identified by second level checks, i.e. close to 12 %. The Commission requested the causes of the high error rate to be identified. A further specific verification exercise was launched by the authorities concerned. One systemic error was analysed and the population concerned was identified, which should already have been done following the first request. Through this further action, the remaining error rate for the second level checks could be reduced to 4,7 %. Although this is above the threshold of 2 % (see paragraph 15), the Commission decided to leave the final resolution of these issues for the closure process that started in October 2010.

- 63.** Where no audits were carried out or where the scope was not sufficient, at least part of the corrective actions were closed on the basis of statements/commitments made or supporting documents provided by the Member State authorities. An example is given in **Box 12**.
- 64.** On the basis of the criteria established, the Court's assessment of the degree of assurance that the Commission obtained in respect of expenditure processed through the improved management and control systems is shown in **Table 4**.

TABLE 4

DEGREE OF ASSURANCE IN RESPECT OF THE EFFECTIVE FUNCTIONING OF THE MANAGEMENT AND CONTROL SYSTEMS AS EVALUATED BY THE COURT

Degree of assurance	Percentage of programmes concerned ¹
High	28
Medium	34
Low	38

¹ For six programmes, the improvements in the systems were not assessed as financial corrections covered all expenditure declared in the programming period. The impact of the corrective actions for these programmes has been taken into account in paragraph 55.

BOX 12

EXAMPLE WHERE A FINDING WAS CLOSED ON THE BASIS OF A DESCRIPTION PROVIDED BY A MEMBER STATE AUTHORITY

For one programme (Navarre), the identification as well as the clearance of the deficiencies were based on reports from Member State authorities. The national authorities informed the Commission that, with regard to the various bodies to which the management had been delegated, new procedures were in place with regard to several measures managed by one body (but did not provide any more detailed information which might have enabled the Commission to judge the quantity and quality of the new checks). For other measures managed by the same body, manuals had been prepared but there were still problems as to the content of the checks. Yet for other bodies, manuals and checklists, which are key elements for ensuring the effectiveness of checks, still did not exist. No further request was made by the Commission.

... THEREFORE FURTHER ASSURANCE HAS TO BE OBTAINED FROM THE CLOSURE PROCESS ...

- 65.** One of the aims of the follow-up of the deficiencies by the Commission was to avoid a long-lasting and resource-intensive closure process so as not to interfere with the ongoing programming period 2007–13. However, in particular for those programmes where the level of assurance obtained was not high, the final assessment of the remaining risk of error will have to be done by the Commission during the closure process which is currently ongoing (see paragraph 15).
- 66.** In order to prepare the closure process, from 2007 the Commission carried out audits at the level of the winding-up bodies responsible for programmes considered to present a high risk with regard to the financial interests of the EU budget. The deficiencies identified during these audits were however mainly considered as remedied by the Commission on the basis of statements made by the authorities concerned (see example provided in **Box 7**).
- 67.** On the basis of the review of the winding-up declarations for those programmes sampled where the Commission concluded positively (87 %, see paragraph 34), the Court concludes that:
- (a) in 23 % of cases (as at the end of June 2011), the information provided in the winding-up declaration will lead to further financial corrections; this relates mainly to cases where the Court considers that the Commission did not have a high level of assurance (see paragraph 55 and **Table 4**);
 - (b) in 57 % of cases, the opinion and/or error rate presented in the winding-up declaration is questionable, in particular because the error rate is too low when compared with the deficiencies that had been identified in the programme. Also, according to the Court's evaluation, there are doubts with regard to the representativity of the results as the second level checks did not need to be carried out on a statistical sample. The results of these checks have, however, to be used as a main building block for the evaluation of the need for further financial corrections.

68. Finally, with regard to the sample audited, there were situations (see **Box 13**) where expenditure initially withdrawn from an expenditure declaration was reinstated in the final expenditure declaration. There were also cases where expenditure regarding newly approved projects was included shortly before the closure deadline. There is a risk that these projects, under the pressure to absorb the EU funds, may not have been checked in an appropriate way.
69. On the basis of its risk assessment of the programmes and with a view to assessing the validity of the error rate presented, the Commission can decide to perform audits in the framework of the closure process. Such audits are now being carried out on around half of those cases where the assurance is considered by the Court not to be high (66 % of those mentioned in paragraph 55 and 36 % of those mentioned in **Table 4**, category 'low'). The number of audits may still increase.

BOX 13

EXAMPLES OF REINSTATEMENT OF INELIGIBLE EXPENDITURE AND OF LATE INCLUSION OF NEW PROJECTS

For one programme (North East of England), which had been subject to corrective actions from March 2006 to September 2007, an amount of 19,3 million euro in expenditure previously deducted was reinstated by the managing authority in the statement of final expenditure. In this case the winding-up body proved to be effective and disclosed the issue.

For another programme (Sardinia) that had been subject to corrective actions since September 2007 and which were ongoing at closure, an amount of 80 million euro of expenditure was included late in the statement of final expenditure. None of the projects concerned had been subjected to second level checks by the independent body. The Commission was able to detect this as it was disclosed in the winding-up declaration, which does not provide a final opinion on the programme. However, the assessment of the eligibility of related expenditure will require further work to avoid the risk of paying for ineligible expenditure.

70. In all the cases where the Commission does not plan to carry out a closure audit, its final decision with regard to the application of further financial corrections will have to rely on the information and statements provided by the winding-up body either in the winding-up declaration or as a result of further requests from the Commission. The Commission may thus not be in a position to assess the veracity and accuracy of the information provided which may relate to key issues such as the arguments²⁴ presented by the authorities for bringing an initially higher error rate down to the 2 % threshold (see paragraph 15). **Box 14** is an illustration of the challenges that the Commission faces at closure.

²⁴ Examples of arguments provided: (i) certain errors are reported as being 'atypical' or (ii) all systemic errors are reported as having been satisfactorily treated.

BOX 14

EXAMPLE OF DIFFERENT INTERPRETATIONS REGARDING THE FINAL ERROR RATE OF A PROGRAMME

As a result of Commission audits, an action plan was agreed in the second half of 2005 for a number of programmes in a Member State. In addition to some specific issues, which were adequately dealt with, the key action required was to strengthen the first level checks. As a result, checks were introduced and/or formalised and relevant guidance notes were prepared. On this basis, the Commission considered the action plan to have been successfully implemented. Nevertheless, there was no requirement in terms of coverage to be achieved by the checks, such as a percentage of projects or of expenditure to be checked. The Commission carried out follow-up audits for a number of programmes, also assessing the quality of first level checks, and no major shortcomings were identified.

However, the audit carried out by the Court on one of the programmes concerned (Yorkshire and the Humber-side) concludes that the first level checks only achieved a very low coverage of 3 %. Furthermore, the error rate established by the first level checks is much lower than the error rate identified by the second level checks, which casts doubts on the quality of the first level checks. This implies that at closure full reliance has to be placed on the results of the second level checks.

The error rate presented in the winding-up declaration for the whole programme is 1,959 %. However, the Court's audit showed that the presentation is not statistically correct as it does not take into consideration the fact that the programme consists of three sub-populations²⁵. Therefore the Court's audit concluded, using the same figures, that the error rate was 9,3 %. The Commission accepted the error rate as presented in the winding-up declaration, with reference to the legal framework.

²⁵ A population (the total number of projects) may be split by grouping the projects into homogeneous sub-populations (strata).

71. Some new provisions were introduced in the regulations for the 2007-13 programming period with the aim of solving some of the problems described in the preceding paragraphs:

- (a) the second level checks are to be done on the basis of a randomly drawn statistical sample; this should improve the validity of the error rates presented to the Commission at closure;
- (b) an audit authority (comparable to the independent body/winding-up body in the 2000–06 programming period) has to present yearly opinions to the Commission as to whether the management and control systems function effectively; they are expected to be more reliable than the Article 13 reports due to the statistical sampling method and will be the main building block for the Commission to draw assurance with regard to the effectiveness of the systems.

²⁶ Member States can have a basket of projects that is bigger in volume than the financial allocation to the programme concerned.

²⁷ At the moment of issuing this report, the Commission had not yet taken a final decision on which amount to apply for the financial correction: the budgeted amount or the declared amount if the latter exceeds the budget.

72. The legal framework for the 2007–13 programming period was also modified by the introduction of, in particular, one simplification with the aim of reducing error rates. Member State authorities now have the possibility to declare overhead expenditure in the form of flat-rates or lump sums instead of actual costs.

... EVEN THOUGH FURTHER FINANCIAL CORRECTIONS MAY NOT HAVE ANY IMPACT AS THE EXPENDITURE DECLARED EXCEEDS THE BUDGET ALLOCATED

73. An analysis of the statements of final expenditure for the 40 programmes reviewed indicates that for 50 % of them (70 % for ERDF programmes and 24 % for ESF programmes), the Member State authorities declared expenditure which exceeds the budget allocated to the programme²⁶. The range of over-declaration goes from 1 % to 28 %. This means, on the one hand, that in all these cases the Member State authorities were able to replace the entire amount of financial corrections agreed in the past (see paragraph 51) by newly declared expenditure and, on the other hand, that the Member State authorities have a buffer to allow for further financial corrections at closure²⁷. In other words, further financial corrections would not lead to a reduction in the final amount to be paid by the Commission.

FURTHER EFFORTS REQUIRED FOR SYSTEMS TO BE EFFECTIVE FOR THE 2007–13 PROGRAMMING PERIOD

- 74.** Considering that many deficiencies were identified between 2006 and 2008 and considering the time required to carry out corrective actions (see paragraph 32), they were often considered as remedied just before commencement of the closure process. This meant that the real improvement in the management and control systems would only take place in the 2007–13 programming period.
- 75.** The systems of the successor programmes in the 2007–13 programming period of 10 of the programmes reviewed were once again evaluated negatively by the Commission in 2010, as reflected in the annual activity reports of the Regional Policy DG and the Employment, Social Affairs and Inclusion DG. The Commission will thus have to take further corrective actions for these programmes.
- 76.** These annual activity reports also indicate that the error rates provided by the audit authorities exceeded the 2 % threshold (see paragraph 15) for 35,6 % of the programmes managed by the Regional Policy DG and 47,4 % of the programmes managed by the Employment, Social Affairs and Inclusion DG²⁸. The DGs' own assessment of the effectiveness of the systems for the 2007–13 period results in 15,4 % of the programmes managed by the Regional Policy DG and 25,8 % of the programmes managed by the Employment, Social Affairs and Inclusion DG being classified as presenting significant deficiencies. The most likely error estimate reported by the Court in its annual report 2010 for cohesion, energy and transport is 7,7 %²⁹.
- 77.** It should be noted that wherever the Commission was successful in bringing the Member States' management and control systems to an effective level, there is still no guarantee that the systems of the successor programmes will be equally effective. This is due to the fact that Member States could change at their discretion the entities, systems and personnel responsible for the control of Structural Funds programmes, for example for budgetary reasons. The Commission has already faced a number of such cases.

²⁸ With regard to the programmes managed by the Regional Policy DG: 22,5 % of the programmes had an error rate ranging from 2 to 5 % and 13,1 % had an error rate exceeding 5 %. With regard to the programmes managed by the Employment, Social Affairs and Inclusion DG: 19,0 % of the programmes had an error rate ranging from 2 to 5 % and 28,4 % had an error rate exceeding 5 %.

²⁹ Lower error rate limit: 4,7 %; upper error limit: 10,7 %.

CONCLUSIONS AND RECOMMENDATIONS

78. The Commission's objective in taking corrective action is to ensure that irregular payments already made are the subject of appropriate financial corrections and that management systems are improved to provide sufficient assurance that future payments are made in accordance with the rules.

79. The Court's audit showed that the Commission generally took appropriate actions when deficiencies were identified but that the process was lengthy and that, for the programmes audited, it obtained varying degrees of assurance that deficiencies in national management and control systems are corrected as a result of its corrective actions.

THE COMMISSION TAKES THE APPROPRIATE ACTIONS WHEN DEFICIENCIES IN MEMBER STATES' SYSTEMS ARE IDENTIFIED BUT THE PROCESS UNTIL IMPLEMENTATION IS LENGTHY

80. The Commission systematically initiated corrective actions when deficiencies were identified. In 90 % of the cases, the Commission addressed the deficiencies appropriately (see paragraphs 23 to 27).

81. However, it took on average 30 months to implement corrective actions. Deficiencies for the 2000–06 period were mainly identified from 2005–06 onwards which, together with a lengthy process, meant that for around half of the cases in the sample financial corrections had to be implemented at closure. The Commission's current policy is that corrective actions should be implemented within 24 months (see paragraphs 32 to 40).

THE COMMISSION HAD SOME SUCCESS IN ENSURING THAT FINANCIAL CORRECTIONS WERE CORRECTLY APPLIED

82. The Commission obtained a high degree of assurance that financial corrections had been properly applied in about two thirds of the cases examined by the Court. For the remaining cases there were shortcomings which reduced the assurance level. This was due to either insufficient information or weaknesses regarding the scope of checks carried out to assess the amount of financial corrections (see paragraphs 44 to 57).

THE COMMISSION WAS LESS SUCCESSFUL IN OBTAINING ASSURANCE THAT ITS ACTIONS LED TO IMPROVEMENTS IN NATIONAL MANAGEMENT AND CONTROL SYSTEMS

- 83.** For the programmes audited (see the *Annex*), the Commission obtained varying degrees of assurance that deficiencies in Member States' management and control systems are corrected as a result of its corrective actions. Out of the programmes audited, the Court found the assurance level to be high in 28 % of the programmes, medium in 34 % and low in 38 %. Further work is being carried out by the Commission during the closure process but difficulties have to be handled to obtain a sufficient degree of assurance regarding the information provided and in particular the final error rate presented in the winding-up declaration (see paragraphs 28 and 58 to 73).
- 84.** For 10 of the programmes reviewed by the Court, their successor programmes in the 2007–13 period were again evaluated negatively by the Commission in 2010. In addition, the error rates reported by national audit authorities under the current period are very often material (see paragraphs 74 to 77). The Commission will have to take further corrective actions for these programmes.

SCOPE FOR IMPROVEMENT

- 85.** Though the Commission's corrective actions can have significant beneficial effects, there remains scope for improvement to stabilise the systems at a good quality level for the 2007–13 period. Improvement is however likely to have resource implications which the Commission will need to take into account.

RECOMMENDATION 1

The Commission should:

- reduce the duration of the administrative procedure from identification of deficiencies until implementation of corrective actions;
- give higher priority to its audit work on the audit authorities to ensure that they produce robust error rates so that financial corrections can be applied on the basis of these error rates;
- disseminate checklists that serve as best practice to be followed by Member State authorities for their first level checks;
- ensure that financial corrections implemented before closure cover all expenditure incurred under deficient management and control systems.

SUBSTITUTION OF INELIGIBLE EXPENDITURE DESERVING CONSIDERATION IN THE CONTEXT OF DECISIONS ABOUT FUTURE SPENDING ON COHESION

- 86.** For half of the programmes examined by the Court, Member State authorities declared expenditure which exceeds the budget allocated to the programme. This means that they were able to replace ineligible expenditure disallowed by new expenditure and to have a buffer to compensate for further potential financial corrections (see paragraph 73).
- 87.** Substitution of expenditure in this way is allowed by the rules (see paragraph 13 (a)) and permits the amounts of Structural Funds' support allocated to Member States to be used in pursuit of expenditure programmes designed to increase economic and social cohesion.

88. The ability of Member States to reuse Structural Funds support in this way however raises issues which deserve consideration, notably in the context of decisions about future spending on cohesion:

- (a) some of the deficiencies identified are systemic (e.g. incorrect application of procurement rules). Unless these are tackled successfully, there is a risk that ineligible expenditure from one project might be replaced by ineligible expenditure from another project;
- (b) there are instances where the new expenditure replacing ineligible expenditure relates to projects fully financed by national funds (retrospective financing). Other Court reports have shown that such projects are more error prone (see footnote 20); in addition, when retrospective financing is used cohesion spending is turned into *ex post* support for the budgets of Member States;
- (c) Commission corrective action has significant resource and administrative costs. Where support has to be reallocated and the Member State has a significant reserve of genuinely compliant projects (see footnote 26), then Commission corrective action results in documentary changes (EU support is attributed to a different set of projects) but not in changes to the activity taking place. Also, as already observed by the Court³⁰, financial corrections do not make the underlying transactions any less irregular but result in shifting the cost of the disallowed irregular transactions from the EU budget to national budgets.

³⁰ Paragraph 1.65 of annual report 2005 (OJ C 263 of 31.10.2006, p. 1).

RECOMMENDATION 2

The Commission, the Parliament and the Council should reconsider, when discussing future plans for spending on cohesion, whether any changes should be made to the arrangements regarding the possibilities for substitution of expenditure found to be ineligible in order to enhance the added value of European funds.

This Report was adopted by Chamber II, headed by Mr Harald NOACK, Member of the Court of Auditors, in Luxembourg at its meeting of 18 January 2012.

For the Court of Auditors



Vítor Manuel da SILVA CALDEIRA
President

PROGRAMMES COVERED BY THE DESK REVIEW

ERDF			
Country	Programme #	Programme name	Budget allocated (in million euro)
Czech Republic	2003CZ161P0003	Industry and Enterprise	347,8
Germany	2000DE162D0003	Saarland	293,0
Spain	2000ES161P0004	Asturias	1 695,4
	2000ES161P0008	Ceuta	89,4
	2000ES161P0010	Extremadura	2 262,4
	2000ES162D0006	Madrid	781,4
United Kingdom	1999GB161D0002	Merseyside	2 600,3
	2000GB162D0005	North East of England	1 716,6
	2000GB162D0012	East of Scotland	661,4
Greece	2000GR051P0003	Health and Welfare	220,2
	2000GR161P0004	Western Greece	530,0
	2000GR161P0007	Epirus	464,7
	2000GR161P0011	Ionian Islands	268,5
	2000GR161P0016	Competitiveness	2 826,2
	2000GR161P0026	Culture	647,6
Ireland	2000IE161P0005	Southern and Eastern Region	829,5
Italy	1999IT161P0010	Sardinia	2 601,0
	1999IT161P0005	Transport	4 520,2
	2000IT162D0009	Lazio	884,4
Poland	2003PL161P0001	Integrated Regional	3 485,3
Portugal	1999PT161P0008	Economy	4 009,3
	1999PT161P0004	Information Society	652,3
Slovakia	2003SK161P0002	Industry and Services	291,0

ESF			
Country	Programme #	Programme name	Budget allocated (in million euro)
Belgium	1999BE053D0002	Ministère Fédéral de l'Emploi et du Travail	140,3
Spain	2000ES051P0015	Entrepreneurial initiative and continuous training	2 279,3
	2000ES053P0305	Navarre	173,4
	2000ES161P0011	Galicia	579,7
France	1999FR161D0002	Nord-Pas-de-Calais	202,1
	2000FR162D0003	Lorraine	84,5
	2000FR162D0019	Picardy	66,2
	2000FR162D0013	Aquitaine	125,4
United Kingdom	1999GB161D0002	Merseyside	1 032,8
	1999GB161D0003	South Yorkshire	1 043,7
	2000GB162D0010	South West of England	81,8
	2000GB162D0003	Yorkshire and the Humberside	142,0
Italy	1999IT161P0007	Campania	1 003,5
	1999IT053P0003	Piedmont	1 054,2
Netherlands	1999NL161D0001	Flevoland	71,4
Poland	2003PL051P0001	Human Resources Development	1 960,1
Slovakia	2003SK051P0001	Human Resources Development	367,2

REPLY OF THE COMMISSION

EXECUTIVE SUMMARY

I. (a)

When implementing the cohesion policy, in line with the shared management principle, Member States are in first instance responsible to prevent, detect and correct irregularities.

Financial corrections should be based on individual irregularities or, when this is not possible or not cost-effective, be based on extrapolation or take the form of a flat-rate correction, determined in accordance with Commission guidelines.

III. (a)

The Commission initiated corrective actions in all cases when deficiencies were identified. It considers that this is a positive result, which demonstrates its strong commitment to fully and correctly exercise its supervisory role in the management of the Structural Funds.

It agrees that the process is lengthy and that is why the 2008 action plan to improve the Commission's supervisory role in structural actions contained measures to speed up legal proceedings and to set up deadlines for the adoption of financial correction decisions (24 months after a final audit report). Under the 2007–13 programmes this policy was continued with the adoption of the timely interruption of payment deadlines when audits identify deficiencies. This is reflected in the lower error rates reported by the Court in the most recent DAS exercises in comparison to the files audited by the Court in this special report.

Nonetheless, in shared management, programmes are multiannual and the Commission and Member States can carry out all necessary corrections until programmes' closure. In particular for large infrastructure projects, complex legal and regulatory issues take time to be sorted out. The Commission considers that the utmost objective is that deficiencies are remedied and that all irregular expenditure is corrected.

REPLY OF THE COMMISSION

III. (b)

The Commission obtained a high degree of assurance that financial corrections had been properly applied in about two thirds of the cases examined by the Court.

For the remaining audited programmes for which it obtained a lower level of assurance, the procedures in place were well respected and financial corrections were implemented as a result of the Commission's diligence to provide a reasonable follow-up on every single case. For these programmes the Commission decided to carry out risk-based closure audits allowing to reach high assurance after closure for these programmes as well.

III. (c)

The Commission did follow-up audits, including on-the-spot, to test systems that went through remedial action plans and took account of the results in its risk analysis for closure.

Having good systems in place aims at ensuring that the EU budget reimburses only legal and regular expenditure, ultimately when closing the programmes. The Commission considers that the levels of financial corrections it applied cumulatively for the 2000–06 programmes in addition to Member States' own corrections and its strict approach during the closure process allow having adequate assurance that the levels of residual error for cohesion as a whole will be low at closure.

The Commission decides on resuming payments after an interruption of payments or a suspension decision on an operational programme only after receiving reasonable assurance from the national authorities on the legality and regularity of expenditure included in subsequent payments claims.

III. (d)

While ensuring legality and regularity of expenditure reimbursed by the Commission, the overall objective of the cohesion policy is to effectively enhance economic and social cohesion. The Commission considers that the voluntary implementation of financial corrections by withdrawal and replacement is a sound financial management practice. Indeed, as soon as affected expenditure is replaced by new eligible projects, the EU budget is protected. Replaced projects should be eligible, legal and regular and in conformity to the programme requirements.

At closure, expenditure declared beyond programme appropriations is taken into account only after all necessary financial corrections have been implemented. Financial corrections for system deficiencies in the closure process as well as irregular expenditure detected after closure will always result in a net reduction of the EU assistance.

This practice aims at ensuring the best possible use of financial resources, at providing an incentive for efficient national controls, while at the same time ensuring the sound management of funds and protection of the EU budget.

IV. (a) first indent

Within the framework of the action plan adopted in 2008, the Commission has adopted a strict policy on suspension of payments and financial corrections, which resulted in shorter deadlines and increased assurance in payments as shown in the evolution of the error rate reported by the Court over the last years.

The Commission notes that in the 2007–13 period interruptions of payment deadlines, a new and more flexible legal tool compared to suspension, have a beneficial effect on the time length of corrective actions.

IV. (a) second indent

Auditing the work of national audit authorities is precisely a core measure in the Commission's audit strategy for the 2007–13 programmes. The Commission is implementing a multiannual audit enquiry with the key objective to review the work of the audit authorities most at risk, in order to be able to rely on their annual audit opinions. This allows the work of the reviewed authorities to be improved, and additional guidance has been discussed and shared with all audit authorities, drawing the lessons from the first results of this enquiry. Focus has therefore been put on ensuring that audit authorities produce robust annual error rates and audit opinions on programmes.

For those cases where limited or no reliance can be placed on the work done by the audit authorities, the Commission conducts its own audit work on the managing and certifying authorities to obtain direct assurance.

REPLY OF THE COMMISSION

IV. (a) third indent

As eligibility rules for the 2007–13 programming period are defined at national level, eligibility checklists can only be defined by managing authorities at the national or programme level. However, the Commission has been giving guidelines to the Member States on the way managing authorities should define and implement their management verifications.

Moreover, the Commission developed in 2009 comprehensive guidelines for first level checks and a self-assessment tool for managing authorities, which they can use to improve their functioning. The Commission has also developed and disseminated in 2011 to audit authorities checklists for the audit of management verifications which can be used by the managing authorities themselves, as a benchmark.

IV. (a) fourth indent

The Commission considers that it already ensures that financial corrections cover all expenditure incurred under deficient management and control systems. The final verification that all affected expenditure has been hit by the financial corrections implemented can only be done at closure, when all financial corrections are cumulated and a residual error rate is calculated.

In that sense, the Commission considers that this recommendation is already implemented.

IV. (b) first indent

The Commission considers that Member States should have the right to substitute ineligible expenditure they detect with legal and regular expenditure in order to optimise the use of cohesion spending, which contributes to its added value and to ensuring efficient controls at Member State level. The Commission's proposal for the 2014–20 regulatory framework provides that 'Where irregularities affecting annual accounts sent to the Commission are detected by the Commission or by the European Court of Auditors, the resulting financial correction shall reduce support from the Funds to the operational programme' (Article 137.6), thereby limiting the possibilities of withdrawal/replacement to the ongoing financial year. This provision is intended as an incentive for expenditure included in the annual certified accounts to be legal and regular.

INTRODUCTION

3.

The Commission notes that the management and control framework for the 2007–13 period contains substantial improvements compared to the 2000–06 period.

6.

The Commission would like to clarify that reporting of error rates was not required annually but only at closure under the legal framework for the 2000–06 period.

7.

The reliability of the error rate is supported by other important elements of the winding-up declaration, for example the independent audit opinion of the winding-up body, the estimation of the frequency of errors, the assessment of the quality and sufficiency of audit work carried out throughout the period, and the assessment of the sufficiency of treatment of errors and weaknesses detected. See also answer to paragraph 6.

9.

In addition to the first and second level checks, the certification of expenditure is another key function in the management and control system introduced in the 2000–06 regulatory framework.

Therefore, controls implemented by the paying authority (2000–06) and the certifying authority (2007–13) on expenditure incurred at beneficiary level and based on the first level checks already carried out by the managing authority should also be taken into account when assessing the global assurance level.

9. (a)

Requirements for the first level checks should be distinguished between the 2000–06 and subsequent period. There was no regulatory threshold for desk and on-the-spot checks, while 100 % desk checks are required in the 2007–13 period.

REPLY OF THE COMMISSION

10.

The annual error rates reported by the Court in its annual report give a snapshot of the situation at the time of the Court's audits before all controls such as the second level checks foreseen by the regulations were carried out. As cohesion policy programmes are implemented over several years and expenditure is subject to several levels of control during this time, the impact of those controls in terms of reducing the error rates and applying the necessary corrective measures is usually only seen in subsequent years.

As reflected in the Commission staff working document of 6 October 2011 and in the 2010 annual report of the Court, although the global error rate remains high for cohesion, the latest error rates calculated by the Court of Auditors for DAS 2009 and 2010 are well below the level reached in previous DAS exercises (2006–08).

The Commission also refers to its reply to paragraph 41.

Box 1 – first indent

An analysis made by the Commission of quantifiable errors reported by the Court since 2006 shows that eligibility constitutes a major source of errors (39 %).

Box 1 – second indent

The same analysis shows that non-existing or inadequate audit trails is also an important (11 %) source of errors, but that is decreasing over the recent years.

11.

In exercising its supervisory role, the Commission has at its disposal many sources of information in addition to EU audits and the national annual control reports, such as bilateral coordination meetings with audit bodies, day-to-day exchange of information on audits and the management of programmes, and the results of OLAF investigations.

12. (a)

Suspension of payments to a programme is adopted by Commission decision after a contradictory process with the national authorities. The pre-suspension letter is only the start of this procedure that may not necessarily lead to a suspension, if the Member State implements the necessary corrective measures in time.

In case serious system deficiencies were detected for the 2000–06 period, and in order to fully respect the sound financial management principle, the Employment, Social Affairs and Inclusion DG took measures to ensure that interim payments were not made.

13. (a)

During the 2000–06 period and in cases where first level checks were deficient, the Commission has requested national authorities to put in place remedial action plans aiming at increasing the quality and coverage of those checks. These included in some cases extensive look-back exercises, in which the national authorities had to control expenditure declared to the Commission in previous years and to apply the necessary corrections.

15.

When estimating the need for financial corrections to be carried out at closure, in addition to the error rate, the Commission also takes into account any corrective and mitigating actions already carried out by the Member State or the Commission. Therefore issues known at the time of closure will be resolved before releasing the final payment of the Commission.

In addition, the Commission has the possibility to impose financial corrections also after the closure of programmes if new irregularities are detected.

16.

The action plan adopted by the Commission in 2008 demonstrated its strong political commitment to work intensively towards the reduction of the error rate in interim payments and the improvement of management and control systems for structural actions.

REPLY OF THE COMMISSION

OBSERVATIONS

23.

The Commission welcomes this positive result, which demonstrates its strong commitment towards the improvement of management and control systems and the correction of detected irregularities.

25.

The Commission welcomes the Court's assessment and considers that this is a positive result. For the other cases, the Commission considers that the remaining issues were manageable and therefore they are being addressed at closure.

The Commission also refers to its reply to paragraph 15.

26.

The Commission welcomes the Court's assessment and considers that this is a positive result. Effectively, the Commission seeks to ensure that, when deficiencies are identified, actions are taken to the widest possible extent and that any areas or programmes which may be affected by the same deficiencies are also included in the scope of those actions.

27.

The Commission welcomes the Court's assessment and considers that this is a positive result. Even in the cases quoted by the Court, the Commission considers that the remaining issues were manageable and therefore they are being addressed at closure.

For the Galicia programme, the Commission refers to its reply to Box 4.

Box 4

The bodies with the highest financial risk were selected for the Commission audit according to a risk-based analysis.

The other bodies under this programme have been covered by national audits (11 system audits), the results of which are available in the Article 13 reports to the Commission.

The remaining issues will be addressed at closure. Further financial corrections will be implemented since the residual error rate is above 2 %.

28.

There was no regulatory threshold for the coverage of first level checks for 2000–06 programmes. The coverage percentage of first level checks needed to be assessed against the programme context; lower coverage may have been sufficient, when the samples checked were representative and if other mitigating measures were in place. Therefore a lower amount checked may not necessarily have resulted in an increased risk that declared expenditure was not regular.

Box 5

For the English programmes, the authorities did not provide for a numerical coverage for Article 4 checks in the ESF guidance. Indeed, the Member State adopted a risk-based approach, which was accepted by the Commission to a certain extent.

Following six audits carried out by the Commission from 2002 to 2005, the ESF guidance on performance of management checks has been strengthened:

- set-up of standardised procedures (such as the obligation for the local bodies to submit yearly the planning of those checks to the central ESF authority in England);
- introduction of checklists developed to support the level of the management checks.

REPLY OF THE COMMISSION

For a specific case (South Yorkshire), first level checks on all projects had been foreseen during their lifetime. For the programme Merseyside, the projects audited were selected on a risk basis. The Member State has indicated that 'a significant amount' of the total number of projects has been foreseen for checks (160 out of 454, i.e. 35 %). Within the checked projects a subset of documents has been controlled. When comparing this total of documents controlled to the global number of documents available for all projects in the programme, the checked percentage can be established at 1,3 %. However, the Commission considers that this low percentage suggests a far lesser level of control than is actually the case.

The managing authority refused to carry out retroactive verifications but agreed instead to implement financial corrections in the context of the closure of the programme (7,3 %).

32.

This assessment is consistent with the one made in the framework of the 2008 Commission action plan and was a reason for proposing, as one of the measures in the action plan, to speed up legal proceedings.

32. (b)

The Commission has made every effort to perform as many follow-up audits as possible, given its resource constraints, in cases where remedial action plans were put in place. Follow-up audits were conducted on a risk basis, taking into account cost-benefit considerations and other sources of evidence of assurance available to the Commission.

The Commission also refers to its reply to paragraph 45.

33.

The Commission notes that during the programming period, financial corrections are in the vast majority implemented very soon after the national authorities have accepted the correction.

34.

Given the important number of issues which are usually treated in the implementation of remedial action plans and the advanced stage in the programming period, it is a pragmatic course of action to close a case and to treat any open issues at closure. This makes human resources available for other audit priorities, without reducing the assurance that the Commission will obtain at the end of the multiannual programming cycle on the legality and regularity of expenditure reimbursed for a programme.

35.

The Commission notes that remedial action plans, following audit findings, generate extensive exchanges of documents that have to be translated for the needs of interservice consultations.

Furthermore, delays can also be due to the fact that the execution of the on-the-spot audits is often outsourced to external audit firms. The Commission resorts to external audit firms as its staff is not sufficient to manage the whole audit plan with its own auditors. The procedure for acceptance of the reports drafted by the audit firm may take longer than expected.

36.

One aim of the 2008 Commission action plan was precisely to urge Member States to take immediate corrective actions, as soon as a weakness is detected, and to demonstrate the Commission's commitment to launch timely legal proceedings, if necessary.

37.

While the Commission in most cases respects the deadlines it has set itself for communicating the audit results, delays in producing the audit report may occur due to the complexity of files, the needs for interservice consultations, or the need for translation of extensive documentation.

The Commission also refers to its reply to paragraph 35.

REPLY OF THE COMMISSION

38.

One consequence of the 2008 Commission action plan was precisely to speed up procedures, while respecting the right of Member States to provide additional information and arguments in order to ensure their rights of defence.

The suspension procedure was not launched or was discontinued when the required actions were implemented as agreed, or when there was no possibility to suspend payments any more before closure. That is why in half of the cases the implementation of the corrective measures could continue without a pre-suspension letter.

39.

The Commission notes that it adopted suspension decisions each time it was necessary.

Suspensions are not primarily intended to speed up the process of implementing remedial action plans. A suspension is a legal measure the Commission has at its disposal to ensure that no payments are made in programmes where significant deficiencies are identified and the Member State authorities do not take appropriate action.

40.

In the report on the first impact of its 2008 action plan, the Commission notes that the actions aimed at improving the reporting and increasing the impact of the Commission's audit activity allowed to speed up most of the ongoing and, at that time new, suspension/financial correction procedures (19 suspension decisions adopted in the framework of the action plan and another six in 2010) and to increase the reported figures on financial corrections as from 2008.

It is underlined that by the end of 2010 and for the programming period 2000–06, the Commission has applied cumulative financial corrections of 5,3 billion euro for ERDF and ESF, a figure which demonstrates the important work done in this field.

The Commission would like to underline the fact that the reference period for the operational programmes sampled by the Court precedes the action plan of 2008.

41.

Interruptions, a legal instrument available for the 2007–13 period, allows taking immediate action, as soon as deficiencies are detected if not yet fully proved. They have therefore improved the Commission's capability to even better protect the EU budget by speeding up the process for the current programmes following reservations in the 2010 and 2011 annual activity reports. The Commission systematically uses the possibility to interrupt payment deadlines when it has evidence suggesting that deficiencies exist, and sends out warning letters when there is no pending payment claim for the concerned programme.

Between 1 January 2008 and 22 December 2011, for ERDF and Cohesion Fund, the Regional Policy DG took measures to ensure that interim payments were not made for 122 programmes and 12 Commission suspension decisions were adopted. For ESF operational programmes, 76 interruptions of payment deadlines and 18 Commission suspension decisions were adopted.

The Commission notes that, in 2010 and for the second consecutive year, the level of error reported by the Court remains well below those reported in its annual reports for the period 2006–08. The Commission considers that this positive and promising development reflects the reinforced control provisions of the 2007–13 programming period and the impact of its 2008 action plan.

For ESF, as reflected in the Commission staff working document of 6 October 2011, the contribution of projects to the cumulative quantifiable errors for cohesion policy dropped significantly in 2008 and 2009, when it was very limited. This positive trend, confirmed in 2010, reflects the continuous implementation of a strict policy on interruptions and suspensions (which was already launched by the Employment, Social Affairs and Inclusion DG since 2008) and the first positive impact of the simplification measures for the 2007–13 period.

43. (b)

The Commission notes that programmes are not exactly the same between the two programming periods, as programme authorities and responsibilities may have been changed compared to the previous period.

REPLY OF THE COMMISSION

45.

For the supervision of programmes implemented under shared management, the Commission has to obtain assurance from the various sources (national or EU) as described by the Court, taking into account the cost and benefits of its choice (see paragraph 46).

The Commission, in the context of its supervisory role, systematically reviews national statements from the Member States, which should be backed by strong national evidence. It also conducts follow-up audits based on a risk assessment, as illustrated by the fact that cases were not closed after the first follow-up audit.

Furthermore, in certain cases, follow-up audits are simply not appropriate where for example financial corrections are carried out on a flat-rate basis or no more interim payments can be reimbursed to the Member State (after the 95 % threshold has been reached) and the amount left to be reimbursed at closure is very small.

46.

The Commission has made a balancing act when deciding to carry out follow-up audits. Follow-up audits are not the only method to obtain high assurance on the implementation of corrective measures and are conducted on a risk basis. Alternative ways exist such as desk reviews on the revised procedures put in place by the Member States. The decision whether to gain assurance on the implementation of audit recommendations (Court, national or Commission source) by a follow-up audit depends on the reliance the Commission can put on the programme authorities, the gravity of the findings as well as their nature.

Box 7

The winding-up body for Scottish programmes was audited and assessed as reliable by the Commission in the framework of its preparatory work for the closure of 2000–06 programmes and a closure audit has taken place to assess the validity of the winding-up declaration. Therefore, the Commission auditors obtained sufficient assurance at closure that all systemic weaknesses identified were effectively addressed. The Commission also refers to its reply to paragraph 45.

48. (b)

Extrapolated corrections are possible only where audits were carried out on a statistical sample of operations. The error rate is then projected for the whole, unaudited concerned population of projects. This is usually possible for limited, homogeneous populations but is resource consuming.

48. (c)

The Commission has adopted guidelines and internal instructions for the determination of proportionate flat-rate corrections in case of systems failures or of lack of compliance with public procurement procedures. These rates are also used by Member States.

49. and 50. Common reply

When agreeing with the Member states on extrapolated and flat-rate corrections, the Commission ensures that all concerned payment claims are corrected, up to the moment in time where the system deficiencies are remedied.

51.

An analysis of quantifiable errors reported by the Court since 2006 made by the Commission in the staff working document of 6 October 2011 also shows that public procurement constitutes a major source of errors (41 % of reported quantifiable errors for ERDF and Cohesion Fund). In addition, the Commission refers to its answers to the 2009 annual report of the Court, in particular paragraph 4.20 where it stated that 'Possible shortcomings in the implementation of public procurement rules at national, regional or local level in applying EU law are not strictly related to the implementation of cohesion projects.' The Commission takes preventive and corrective actions to address such infringements of public procurement rules in programmes funded under the cohesion policy.

REPLY OF THE COMMISSION

52.

In accordance with Article 39 of Regulation (EC) No 1260/1999, amounts released through financial corrections agreed and implemented by Member States can be reused for other eligible expenditure and only financial corrections decided by the Commission are net. The Commission considers that this is an incentive for Member States to appropriately detect irregularities and to withdraw any irregular expenditure from previous payment claims already reimbursed by the Commission. The Commission also refers to its reply to paragraphs 68 and 88 (b) and (c).

54.

The Commission refers to its reply to paragraphs 45 and 46.

Box 8

This example shows indeed that the Commission is satisfying itself that problems have been satisfactorily corrected before it can close a case.

55.

The remedial actions undertaken (action plans and financial corrections applied by the Commission totalling 5.3 billion euro for ERDF and ESF cumulatively for the programming period 2000–06) mitigated the risk related to the implementation of programmes during the programming period. Therefore, in the Commission's opinion, for the majority of programmes the assurance level was high.

For the remaining limited number of programmes with less assurance, the Commission decided to carry out risk-based closure audits allowing high assurance at closure to be reached for these programmes as well.

For the specific issues, please refer to the Commission's reply to Boxes 9 and 10.

56 (a)

The Commission obtains at closure assurance on the completeness and accuracy of all financial corrections carried out in the lifetime of the programme. Moreover, the Commission can carry out closure audit missions to the paying or other programme authorities, during which the implementation of financial corrections is checked for a sample of programmes. This was effectively the case for one of the programmes in which the Court has identified shortcomings.

Box 9

Before payments resumed the Commission was able to calculate all the corrections made. The most important correction was assessed on the basis of work of the Galician Statistics Institute, which answered the Commission's requirements perfectly.

57.

The Commission refers to its reply to paragraph 9 (a), where it indicates that neither a 100 % check of projects nor a statistical sampling approach were required for the period in question.

The coverage of the checks needed to be assessed against the programme context; lower coverage may have been sufficient, when the samples checked were representative and if other mitigating measures were in place. Therefore a lower amount checked may not necessarily have resulted in an increased risk that declared expenditure was not regular.

Box 10

The remaining issues have been identified by the Commission as a particular risk for the closure of this programme. The final results of the enquiry carried out will be assessed by the Commission during the closure audit mission for this specific programme. Thus, additional financial corrections may be applied.

REPLY OF THE COMMISSION

For the contracts which were not awarded on the basis of the accelerated procedure, the occurrence of various types of errors was not systematically checked by the Commission since it considers that it did not have sufficient basis to carry out additional financial corrections. Further audit work was not deemed necessary since the main weaknesses were corrected.

58.

The Commission refers to its reply to paragraphs 9, 10, 11 and 28.

The Commission considers that the 2000–06 legal framework regarding the requirements for second level checks was adequate and provided a good basis for the work of the audit bodies.

The legal framework for the period 2007–13 further enhanced the provisions of the previous period. It is however underlined that the first level checks remain a key element in the 2007–13 period, without this implying a weakness in the legal requirements for second level checks in the previous programming period.

59.

A follow-up audit by the Commission is not the only method to obtain high assurance on the implementation of corrective measures. The decision whether to gain assurance on the implementation of audit recommendations (Court, national or Commission source) by a follow-up audit or through alternative ways, such as desk reviews of (new) procedures, depends also on the reliance the Commission can put on the programme authorities, the gravity of the findings as well as their nature. In other situations, where national control bodies are common to different programmes, the results of the follow-up audit carried out by one Commission service can be shared with other concerned services.

60.

The Commission assesses the assurance it can draw from systems based on all key requirements in place, including for 2000–06 programmes the work of the paying authority before certifying expenditure. The Commission considers that, due to the principles of shared management and single auditing, it can base part of its assurance and rely on national audit reports for 2000–06 programmes when it has information that confirms the reliability, independence and professionalism of such audit bodies. As indicated in the Commission's reply to paragraph 45, the Commission should also make the best use of its resources to obtain assurance and to follow-up remedial action plans implemented in the Member States.

Box 11 — first request

This first action plan was conducted on a large statistical sample (one seventh of all files, 269 in number). An analysis of the error rate of 2,12 % showed that errors were concentrated in the years 2000 and 2001. The error rate was well below 2 % for the years 2002, 2003 and 2004. It should be noted that the first action plan was carried out on a much larger population (and selected on a statistical basis) than the second level checks which, from a Commission point of view, could explain the difference with the second level checks.

Taking into account the overall error rate just above 2 % of the first action plan and the low error rates from 2002 onwards, together with the confirmation that procedures had been reinforced, the Commission considered that payments for this programme could be resumed.

Box 11 — second request

The difference between the error rate from the action plan (2,12 %) and the one from the Article 10 checks is due to the characteristics of the sampling procedure: the sample for the action plan was extracted on a statistical basis (one seventh of the 2000–04 projects) whilst the sample for the Article 10 checks includes also risk selected projects. This explains the higher error rate of the Article 10 checks.¹

¹ According to Article 10(2) of Regulation (EC) No 438/2001, Member States shall organise checks on operations on a representative sampling basis, which includes the following elements: the need to check an adequate mix of operations, any risk factors which have been identified by national or Community checks and the concentration of operations under certain intermediate bodies or certain final beneficiaries.

REPLY OF THE COMMISSION

The Commission did not question immediately the difference between the results of the first action plan and the second level checks since the latter were expected to decrease as a result of the first action plan. However, less than a year later, the Commission requested to launch a second action plan because of the persisting high error rate of the second level checks.

During the implementation of the second request for action, it was clearly pointed out to the French authorities that remaining error rates higher than 2 % at the stage of closure could imply financial corrections. The French authorities should therefore continue remedial actions to further reduce the error rate.

The closure exercise for the Aquitaine programme has been interrupted and additional information was requested on the calculation of the residual error rate. The information was received on 1 April 2011 and is subject to an ongoing Commission analysis.

61.

The Commission assesses the assurance it can draw from systems based on all key requirements in place, including for 2000–06 programmes the work of the paying authority before certifying expenditure, which can be a mitigating factor to considering the whole system satisfactory. Since there is no regulatory requirement on the volume of first level checks to be carried out, the assessment must take into account all available mitigating factors (see also reply to paragraph 28).

62.

Concerning the ERDF English programmes identified by the Court under this category, the quantity of checks to be done was agreed with the authorities. The action plan agreed with the programme authorities were to cover at least 30 % of programme spendings, underpinned by a minimum of 10 % spending check back to source documentation at each on-the-spot visit of the service in charge of verifications. In addition, a minimum coverage was set, dependent on total project numbers.

The Commission also refers to its reply to paragraph 28.

Box 12

For Navarre, the Commission considers that the main weaknesses identified were cleared on the basis of the national audit report:

The Commission confirms that the report referred to by the Court describes the measures taken with the amount of detail required by the applicable rules and in a satisfactory manner.

64.

The Commission notes that it systematically initiated corrective actions when deficiencies were identified and that audit evidence of the implemented actions (either through its own audits or through the programme's audit body) is ensured for 90 % of the cases. Furthermore, the Commission will include the remaining programmes in its closure audits (see reply to paragraph 69).

For the six programmes in the sample for which financial corrections taken covered the whole programming period (see footnote in Table 4), the Commission had high assurance on the corresponding expenditures as well.

65.

As the Commission has often noted, closure is a key process in the multiannual corrective mechanism for Structural Funds and a final security net to ensure legality and regularity. At closure, in any case, a thorough analysis of the sufficiency of the corrective actions already taken by the Member States and the Commission is carried out in order to be able to address any remaining risks to the EU budget. Additional closure audits, which may allow further irregularities to be detected, are carried out, based on a risk assessment arising from the closure process.

66.

In the framework of the preparatory audit enquiry carried out from 2007 onwards to review the winding-up bodies in order to verify the assurance which can be placed on their closure work underpinning the winding-up declarations for the 2000–06 programmes, 42 audit missions were carried out with a view to verifying the preparation of Member States for closure and to identify and mitigate risks. The audit exercise covered approximately 85 % of the decided amount for the 2000–06 programmes at the end of 2010.

REPLY OF THE COMMISSION

The deficiencies identified were followed-up during the normal contradictory procedures leading also in some cases to follow-up missions being carried out by the Commission, where this was considered necessary.

The Commission also refers to its reply to Box 7.

67. (a)

The Court's observation that further corrections will be implemented based on information in the winding-up declarations illustrates the fact that the Commission takes the closure exercise very seriously as a last security net to ensure legality and regularity of the programme's expenditure, even when problems were deemed to have been treated satisfactorily in the lifetime of the programme.

67. (b)

The Commission has mitigating actions in place to address the risks identified at closure. Based on its risk assessment, the Commission carries out specific closure audits to verify and validate the quality of the winding-up declaration.

The information provided by the winding-up body (WUB) is based on the cumulative audit information originating from all audit sources (national, Court and Commission audits), including from additional audits carried out at closure by the winding-up body when necessary.

The checklist used by the Commission at closure covers these issues.

The Regional Policy DG has a specific closure review panel which meets regularly to ensure consistency in the most difficult cases.

68.

The Commission has clarified to Member States that the practice of reinstating irregular expenditure previously withdrawn is in general not allowed.

The Commission is aware of the risk of retrospective projects, which concerns in particular a limited number of Member States and programmes.

During the assessment of the winding-up declarations, the Commission is therefore carefully addressing these risks (in particular in the closure risk assessment established per Member State by the Commission).

Box 13 - Common reply for both examples

In these cases the winding-up bodies proved to be effective in disclosing the issue in the winding-up declaration. The reintroduction of expenditure at risk has been considered in the context of the closure of the concerned programme. One of the objectives of closure audits is to verify the level of supervision exercised by the winding-up body on the work carried out by the managing authority under the special enquiry on public procurement before issuing the winding-up declaration.

69.

As stated in the Commission's reply to paragraph 64, the closure process, including closure audits, will in many cases allow to complement the assurance obtained when assessing the implementation of remedial actions, thus allowing high assurance for all programmes. Closure is a dynamic process and additional audits may be decided based on the results of the assessment of winding-up declarations or of additional information requested and communicated or not by the Member States.

70.

The Structural Funds are managed through shared management and therefore there always has to be an element of reliance on the work of the Member State authorities.

REPLY OF THE COMMISSION

Furthermore, the Commission services have at their disposal at closure the results of the enormous amount of audit work carried out during the programming period, which has helped to identify any issues or risks in the reliability of the management and control systems, for example on the independence of audit bodies. The Commission also refers to the extensive enquiry to review the work and methodologies of the winding-up bodies prior to closure. Where previous audit results raised concerns on the reliability of a winding-up body, the Commission services have taken this into account in their risk assessment and analysis of the submitted closure documents. When the information provided by the winding-up declaration is not exhaustive, additional background information is requested to the Member State. The risk-based closure enquiry set out in the Commission's audit strategy includes 50 programmes, being the equivalent of 9,5 % of all 525 ERDF and ESF programmes. If considered necessary, further on-the-spot audit work may be carried out up to 3 years following the closure letter.

Moreover, the Commission recalculates the residual error rate presented in the winding-up declaration if some errors or misinterpretations are present and imposes financial corrections when such error rate is beyond 2 %.

Box 14

The process of closure of the programme Yorkshire and the Humberside was based on the underlying audit results, applied consistently throughout the 2000–06 period. The calculation of the error rate in the winding-up declaration was aligned according to the sampling that has been taking place over the whole period — based on a methodology defined in the beginning of the period and in compliance with Article 10(2) of Regulation (EC) No 438/2001.

This methodology met the dual requirements concerning the sample — representative (random) and based also on risk analysis.

The calculation of error rate and residual error rate at closure has been made by the winding-up body in accordance with the same sampling methodology. Therefore, in consideration of the regulatory requirements in effect, the Commission considered the residual error rate to be accurate and accepted unconditionally the winding-up declaration.

The Court proposes an alternative methodology for the process of sampling, which treats the population differently, dividing it into three sub-populations based on criteria which are not part of the sampling methodology of the audit body.

71. (b)

The Commission refers to its assessment of the reliability of a sample of 2007–13 audit authorities published in the 2010 annual report of the Court. The Commission continues to work with audit authorities to further harmonise their audit approach and ways of presenting error rates in their annual control reports.

72.

In addition to simplified cost options for ESF and ERDF under the 2007–13 programmes (use of indirect costs declared on a flat-rate basis up to 20 % of direct costs, standard scales of unit costs or lump sums), the use of national (or sometimes regional) eligibility rules to manage programmes is also considered as an important simplification and a way to avoid compliance errors against EU rules which are not always well known and understood.

73.

The declaration of additional expenditures beyond the programme resources (overbooking) requires an investment by the Member State in order to ensure an optimal utilisation of the funds. Not all Member States can necessarily decide to make this investment.

The Commission services take into account overbooking when implementing financial corrections at closure, as always done during programme implementation.

The purpose of financial corrections is not to sanction Member States in systematically reducing the allocated EU co-financing, but they are a means to ensure that at closure only legal and regular expenditure has been reimbursed by the EU budget. However, financial corrections for system deficiencies in the closure process, as well as irregularities and deficiencies detected in an audit conducted after the closure of programmes, will result in a net reduction of the EU assistance.

REPLY OF THE COMMISSION

74.

Improvements in 2000–06 systems may benefit the 2007–13 systems under strict conditions that the same authorities and rules are applied, but also through the improvement of know-how of the national authorities.

75.

The only moment where a final conclusion can be reached on the functioning of an operational programme is at closure where a residual error rate is established taking into account all financial corrections incurred during the life of the programme. The Commission does take action for the programmes under reservation in the annual activity reports.

76.

The Commission underlines that error rates reported by Member States' audit authorities at the end of 2010 are only one element for the Commission to assess the effectiveness of management and control systems for the purpose of the annual assurance of Directors-General. The Employment, Social Affairs and Inclusion DG indicates in its 2010 annual activity report (page 45) that the average estimated error rate for all 2007–13 ESF programmes based on the 2010 annual control reports submitted by audit authorities covering 2009 expenditure is in the range of 2,5 % to 3 %.

Annual activity reports from the Regional Policy DG and the Employment, Social Affairs and Inclusion DG provide a comprehensive assessment of the management and control systems for all programmes under Structural Funds, based on all sources of assurance available to services. In the 2010 annual activity reports of both Commission services, 10 % and 12 % respectively of all programmes for the programming periods 2000–06 and 2007–13 are classified in the two lowest categories of assurance. The remaining 90 %-88 % of programmes are deemed to be functioning effectively or with only minor improvements needed.

77.

The possibility to change their national management and control systems is limited by the obligation to submit the *ex ante* description of their systems to the approval of the Commission, before the first interim payment on the operational programme (Article 71 of Regulation (EC) No 1083/2006) together with an audit strategy (Article 62 of Regulation (EC) No 1083/2006). The Commission considers that the compliance assessment has contributed to reducing errors.

Error rates reported by the Court so far in 2009 and 2010 also show that the current systems better prevent errors than in the past. In an analysis of quantifiable errors reported by the Court since 2006 made by the Commission in the staff working document of 6 October 2011, the Commission services conclude that errors are concentrated under some programmes in few Member States. Additional efforts are though still necessary to bring the overall error rate to more acceptable levels.

CONCLUSIONS AND RECOMMENDATIONS

79. and 80. Common reply

The Commission welcomes the fact that the Court concludes in paragraph 80 that 'The Commission systematically initiated corrective actions when deficiencies were identified.' The Commission considers that this is a positive result, which demonstrates its strong commitment to fully exercise its supervisory role in the management of the Structural Funds. Furthermore, the Commission has included in its closure audits programmes for which some issues remain, thus allowing to reach high assurance at closure for these programmes as well (see reply to paragraph 69).

81.

In the 2008 action plan to improve the Commission's supervisory role in structural actions, one of the measures proposed was intended to speed up legal proceedings and it set up deadlines for the adoption of financial correction decisions (24 months after a final audit report).

REPLY OF THE COMMISSION

Nonetheless, in shared management, programmes are multiannual and the Commission and Member States can carry out all necessary corrections until programmes' closure. In particular for large infrastructure projects, complex legal and regulatory issues take time to be sorted out. The Commission considers that the utmost objective is that deficiencies are remedied and that all irregular expenditure is corrected.

82.

The Commission welcomes the Court's conclusions. It considers that it obtained a high degree of assurance that financial corrections had been properly applied in about two thirds of the cases examined.

For the remaining audited programmes for which it obtained a lower level of assurance, the procedures in place were well respected and financial corrections were implemented as a result of the Commission's diligence to provide a reasonable follow-up on every single case. For these programmes the Commission decided to carry out risk-based closure audits allowing high assurance after closure to be reached for these programmes as well.

83.

The Commission considers that it carried out follow-up audits each time it needed additional assurance from information provided, on a risk basis. For the other cases, the Commission has to make the best use of its resources and rely on national audit reports.

When initiating corrective actions, the Commission seeks to ensure that adequate assurance can be obtained on the declared expenditure, taking into account the overall robustness of the existing systems and their effectiveness in preventing errors (see also reply to table 4 in paragraph 64). The remedial actions undertaken (action plans and financial corrections applied for the programming period 2000–06) allowed mitigating the identified risks in all cases. For the remaining programmes with less assurance, the Commission decided to carry out risk-based closure audits allowing high assurance at closure to be reached for these programmes as well.

84.

The effectiveness of management and control systems evolves over time and audit opinions issued for the programmes in the annual activity reports of the Structural Funds services only relate to the year covered by the report. Many observations issued at the beginning of the 2007–13 period were due to causes totally different to the implementation of the previous period.

Therefore, the Commission is not convinced that a direct link can be made between all programmes in the two programming periods, in order to be able to refer to successor programmes.

The Commission continues its strict approach in supervising 2007–13 programmes. Improvements obtained in systems have to be continuously monitored, and the annual error rates and audit opinions provided by the audit authorities for 2007–13 programmes allow to do this continuous monitoring based on improved indicators.

The Commission does take action for the programmes under reservation in the annual activity reports.

85.

The Commission agrees that there remains scope for improvement to stabilise the systems at a good quality level for the 2007–13 period. It is committed to make every possible effort to ensure that this improvement comes about the soonest possible.

Recommendation 1 — first indent

Within the framework of the action plan adopted in 2008, the Commission has adopted a strict policy on suspension of payments and financial corrections, which resulted in shorter deadlines and increased assurance in payments as shown in the evolution of the error rate reported by the Court over the last years.

The Commission notes that in the 2007–13 period, interruptions of payment deadlines, a new and more flexible legal tool compared to suspension, have a beneficial effect on the time length of corrective actions.

REPLY OF THE COMMISSION

Recommendation 1 — second indent

Auditing the work of national audit authorities is precisely the principal enquiry in the Commission's audit strategy for 2007–13 programmes. The Commission is implementing a multiannual audit enquiry with the key objective to review the work of the audit authorities most at risk, in order to be able to rely on their annual audit opinions. The Commission review on audit authorities, started in 2009, was also an opportunity to develop capacity-building actions towards national audit authorities, as further explained in the 2010 annual activity reports of the Directors-General of the Regional Policy DG and the Employment, Social Affairs and Inclusion DG. This allowed improving the work of the reviewed authorities. Focus has therefore been put on ensuring that audit authorities produce robust audit opinions and error rates on programmes.

Recommendation 1 — third indent

As eligibility rules for the 2007–13 programming period are defined at national level, eligibility checklists can only be defined by managing authorities, at national or programme level. However, the Commission has been giving guidelines to the Member States on the way managing authorities should define and implement their management verifications.

Moreover, the Commission developed in 2009 comprehensive guidelines for the first level checks and a self-assessment tool for managing authorities, which they can use to improve their functioning. The Commission has also developed and disseminated in 2011 to audit authorities checklists for the audit of management verifications which can be used by the managing authorities themselves, as a benchmark.

Recommendation 1 — fourth indent

The Commission ensures that financial corrections cover all expenditure incurred under deficient management and control systems. The final verification that all affected expenditure has been covered by the financial corrections implemented can only be done at closure, when all financial corrections are cumulated and a residual error rate is calculated.

In that sense, the Commission considers that this recommendation is already implemented.

86.

The overall objective of the cohesion policy is to enhance economic and social cohesion.

The regulatory framework on Structural Funds expressly gives the possibility to the Member States to voluntarily implement financial corrections, without Commission decision, by withdrawing the affected expenditure and replacing it by new unaffected expenditure, in an interim payment claim. This possibility aims at ensuring the best possible use of financial resources, and not at punishing Member States by systematically reducing the allocated funds, while at the same time ensuring the sound management of funds and protection of the EU budget.

At closure, overbooked expenditure is taken into account only after all necessary financial corrections have been implemented.

Financial corrections for system deficiencies in the closure process will always result in a net reduction of the EU assistance, as well as irregularities and deficiencies detected in an audit conducted after the closure of programmes.

87.

While ensuring legality and regularity of expenditure reimbursed by the Commission, the overall objective of the cohesion policy is to effectively enhance economic and social cohesion. The legal possibility for Member States to substitute expenditure goes in that direction, in that it aims at ensuring the best possible use of financial resources, but also at not sanctioning Member States by systematically reducing the allocated funds, while at the same time ensuring the sound management of funds and protection of the EU budget.

88. (a)

When the Commission identifies systematic deficiencies, remedial actions are imposed on the concerned Member States to prevent similar errors in future operations.

The Commission also refers to its reply to paragraph 87.

The new expenditure must be in conformity with all applicable rules. In addition, where errors systematically occur as a result of an incorrect transposition or application of EU law, the Commission also initiates infringement procedures.

REPLY OF THE COMMISSION

88. (b)

The co-financing of retrospective projects by the EU budget is subject to the full conformity of these projects to the eligibility criteria of the related operational programme and must be submitted to the same level of control as all other expenditure incurred under the operational programme. Where the requirements are not met the Commission imposes financial corrections.

The issue of retrospective projects differs from the replacement of irregular expenditure by legal and regular expenditure, in full conformity to all rules applicable to the operational programme. In this sense, as already mentioned in the Commission's reply to paragraph 86, this possibility aims at ensuring the best possible use of financial resources, and not at sanctioning Member States by systematically reducing the allocated funds, while at the same time ensuring the sound management of funds and protection of the EU budget.

88. (c)

The Commission considers that the cost-effectiveness of corrective measures cannot be based on whether or not they result in a net reduction of the funding support to an operational programme, but rather on whether they ensure legality and regularity of the underlying transactions of the concerned programme. The cost of such corrective measures is thus entirely justified. This objective is achieved regardless of whether the impact of those corrections is absorbed by genuine additional expenditure incurred as overbooking beyond the programme's allocations. The Commission corrective action intends to ensure that Structural Funds spending is dedicated to compliant projects, thereby protecting the EU budget as well as contributing to cohesion policy objectives. Member States are required to recover the irregular expenditure from the concerned project beneficiaries. Therefore, it cannot be considered as a burden for the tax payers. When this is not possible, for example because the responsibility for irregularities is with the Member State administration (system deficiencies) and not with individual beneficiaries, the financial burden falls upon the national budget of the concerned administration. Financial corrections are a useful tool for Member States to improve their management and control systems and to prevent irregularities in the future. Corrections imposed to Member States mean less revenue from the EU budget than initially planned and the necessity to find additional national public funds to pay for the projects not eligible for EU co-financing.

Recommendation 2

The Commission considers that Member States should have the right to substitute ineligible expenditure they detect with legal and regular expenditure in order to optimise the use of cohesion spending which contributes to its added value and to ensure efficient controls at Member State level. The Commission's proposal for the 2014–20 regulatory framework provides that 'Where irregularities affecting annual accounts sent to the Commission are detected by the Commission or by the European Court of Auditors, the resulting financial correction shall reduce support from the funds to the operational programme' (Article 137.6), thereby limiting the possibilities of withdrawal/replacement to the ongoing financial year. This provision is intended as an incentive for expenditure included in the annual certified accounts to be legal and regular.

European Court of Auditors

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WHEN SIGNIFICANT DEFICIENCIES ARE IDENTIFIED IN THE MEMBER STATES' MANAGEMENT AND CONTROL SYSTEMS FOR STRUCTURAL FUNDS, THE COMMISSION HAS TO ENSURE THAT PAST IRREGULARITIES ARE CORRECTED AND THAT SYSTEMS ARE IMPROVED FOR THE FUTURE. IN THIS REPORT THE COURT ASSESSED WHETHER THE COMMISSION DEALT IN A SATISFACTORY WAY WITH DEFICIENCIES IDENTIFIED IN THE MEMBER STATES' SYSTEMS.



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