TAKING STOCK OF ‘SINGLE AUDIT’ AND THE COMMISSION’S RELIANCE ON THE WORK OF NATIONAL AUDIT AUTHORITIES IN COHESION
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(pursuant to Article 287(4), second subparagraph, TFEU)

EUROPEAN COURT OF AUDITORS
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REPLY OF THE COMMISSION
Article 73: Article 73 of Council Regulation (EC) No 1083/2006 stipulates that the Commission may rely on the work carried out by a national audit authority, and reduce its own audits and checks, once it has accepted the national compliance assessment and the audit authority’s audit strategy and if it has obtained reasonable assurance that the management and control systems of the Operational Programme function effectively.

Compliance assessment: The term ‘compliance assessment’ refers to a process whereby an independent audit body (which can be the national audit authority evaluates the design of management and control systems for an (or a group of) Operational Programme(s) (the ‘compliance assessment report’) and provides an opinion as to whether they comply with the Regulations (the ‘compliance assessment opinion’). The Commission must accept the compliance assessment before expenditure incurred under the Operational Programme can be reimbursed from the EU budget.

Contracts of confidence: These are bilateral administrative arrangements signed with national authorities by the Commission during the 2000–06 programming period if it had reasonable assurance that the financial management and control systems for one or more funds complied with the requirements of Commission Regulation (EC) No 438/2001 and that the national authorities had drawn up a satisfactory audit strategy. The Member State also undertook to submit reports on its audit activities to the Commission. Where a contract of confidence was signed, the Commission agreed in principle that it would no longer carry out audits in the Member State (or region) concerned. Contracts of confidence were signed between 2005 and 2009 with Austria, Cyprus, Denmark, Estonia, Portugal, Lithuania, UK (England), UK (Wales) and Slovenia for 55 OPs.

Financial corrections: Financial corrections aim at protecting the EU budget from the burden of erroneous or irregular expenditure. For expenditure subject to shared management, recovering payments incorrectly made is the primary responsibility of Member States. Financial corrections can be made by withdrawing irregular expenditure from Member States’ expenditure declarations or through recoveries from beneficiaries. Financial corrections can also be imposed by the Commission.

Internal control: Internal control is understood as a process which is designed to provide reasonable assurance regarding the achievement of an organisation’s objectives in terms of the effectiveness and efficiency of its operations, the reliability of its financial reporting and its compliance with laws and regulations.

Internationally accepted audit standards (IAAS): Audit authorities must take account of internationally accepted audit standards in their audit work. The IAAS comprise auditing standards specified by different public and professional standard-setting bodies, such as the International Standards on Auditing (ISAs), the international auditing standards of Supreme Audit Institutions, implementation guidelines issued by INTOSAI and the guidance notes published by the Institute of Internal Auditors.

Materiality level: Auditors express an opinion as to whether financial statements are prepared, in all material respects, in conformity with a certain set of rules. The assessment of what is material is a matter of professional judgement. The materiality level used by the Commission is 2 %, which refers to the ratio of erroneous or irregular expenditure to the EU spending audited. In Cohesion, the Commission uses this threshold for both the annual projected error rate and the multiannual residual error rate at the level of each OP.

(National) audit strategies: Audit authorities’ audit strategies indicate, for each OP (or group of OPs), the systems and bodies which will be examined, the audit approaches and methods to be used, the sampling method for audits on operations and the indicative timetable for these audits. National audit strategies are approved by the Commission.

Operational Programme (OP): Expenditure from the ERDF, CF and ESF is allocated through multiannual Operational Programmes, which set out a development strategy with specific priorities to be carried out with the aid of the fund or, in the case of the Convergence objective, with the aid of both the CF and the ERDF. Programming documents are submitted by Member States and adopted by the Commission.
Projected error rate: An audit authority’s estimate of the part of the annual expenditure for each OP (or group of OPs) which is not legal and regular. This rate should be established on the basis of a statistical sampling approach. Projected error rates must be representative for the expenditure incurred for the OP (or group of OPs). This may also be the case for error rates established on the basis of specific non-statistical sampling methods (in particular for small populations), as long as they are representative of the population as a whole.


Residual error rate: The Commission’s estimate of the part of the expenditure paid during the entire programming period for each OP (or group of OPs) which is not legal and regular. Residual error rates are calculated by the Commission on the basis of the audit authorities’ representative annual projected error rates as validated by the Commission. These annual rates are then applied to the expenditure paid during the programming period, and all financial corrections implemented since the start of the programming period at national level (through withdrawals and recoveries) and EU level (through formal Commission decisions) are deducted. This calculation results in the cumulative residual amount at risk. The residual error rate is the ratio of this amount to the total expenditure paid since 2007.
ABBREVIATIONS

**CF**: Cohesion Fund

**COCOF**: Coordination Committee of the Funds

**EC**: European Community

**ERDF**: European Regional Development Fund

**ESF**: European Social Fund

**EU**: European Union

**IAAS**: Internationally accepted audit standards

**ISA**: International standard on auditing

**OP**: Operational Programme
EXECUTIVE SUMMARY

I. Through this audit, the Court analysed the extent to which the Commission is able to rely, in the area of Cohesion, on the work of national audit authorities and took stock of the Commission’s implementation of the ‘single audit’ model (as specified in Article 73 of Regulation No 1083/2006). The report covers the period from 2010 to the end of 2012.

II. Shared management arrangements imply that the Commission has to be able to rely on Member States in its supervision of the EU budget. The Court found that Member States and the Commission have made significant efforts to establish a better system for auditing Cohesion spending for the 2007-13 programming period.

III. However, this has come at a cost. The Court estimates the specific annual ‘cost of control’ for audit authorities at between 110 and 130 million euro. This corresponds to around 0.2% of the total budget (in terms of EU and national public and private funding) for all ERDF/CF and ESF Operational Programmes (OPs). In this respect, the Court would observe that internal control systems require an appropriate balance between the cost of checks in a particular budgetary area and the benefits those checks bring in terms of limiting the risk of loss and irregularity to an acceptable level.

IV. Since the start of the programming period, the Commission has made considerable progress on developing a system based on which it can draw assurance as to the legality and regularity of ERDF/CF and ESF expenditure from the work of national audit authorities, and on providing guidance material which contributes to better consistency in audit authorities’ approaches and working methods.
V.
However, the Court identified a number of risks in the Commission’s reliance on the error rates reported by audit authorities and the information on financial corrections reported by Member States. The Commission may therefore underestimate the problems in its reporting to the European Parliament and the Council and incorrectly assess what is needed to achieve an unqualified audit opinion in the Cohesion area.

VI.
The Court notes that ‘single audit’, as specified for Cohesion in Article 73, should be the rule rather than the exception. The Court found, however, that the Commission faces considerable challenges to its effective implementation of the ‘single audit’ provisions. As in the previous programming period, only a limited number of ERDF/CF and ESF OPs were compliant with the necessary conditions for ‘single audit’ status by the end of 2012.

VII.
The Court makes a number of recommendations in this report regarding the Commission’s use of the work of national audit authorities in Cohesion. In particular, the Commission should:

— strengthen its verifications of the accuracy and reliability of the error rates reported by national audit authorities and the information on financial corrections reported by Member States before using these elements in its own assurance process;

— in all cases apply robust, consistent and transparent criteria when granting ‘single audit’ status to Operational Programmes;

— comply in its monitoring of Article 73 OPs (and the corresponding audit authorities) with the requirements in the international standards on auditing for using the work of other auditors;

— introduce a system of net financial corrections for OPs in respect of which the audit authorities repeatedly under-report problems, based on the applicable provisions in the Regulations for the 2014–20 programming period;

— take appropriate measures so that audit authorities can draw on a stable and binding methodological framework; and

— propose arrangements for Member States and the Commission to share the costs of Cohesion controls, based on a more recent evaluation of the actual costs incurred by Member States.
INTRODUCTION

SHARED RESPONSIBILITIES FOR INTERNAL CONTROL IN COHESION

1. In Cohesion, EU financial support is granted through the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF). Taken together, the three funds had a total budget (EU and national public and private funding) of 491 billion euro for the 2007–13 programming period (see Annex I).

2. Cohesion policy is a shared competence of the Member States and the Commission. The Commission approves multiannual OPs on the basis of Member States’ proposals. A total of 434 OPs had been approved for the 2007–13 programming period (317 under the ERDF/CF and 117 under the ESF) by the end of 2012. The eligibility rules for each of these OPs are laid down by national authorities, subject to exceptions in the specific regulations for each fund.

3. For each OP, the Commission has to satisfy itself that the Member States have set up robust internal controls and that these systems function effectively — in other words, the Member States’ internal controls must provide reasonable assurance that errors in transactions underlying the accounts are either prevented or identified and corrected before the expenditure is certified to the Commission.

4. At national level, the internal control of OPs is the responsibility of a managing authority, a certifying authority (see Box 1) and an audit authority. Together, these bodies must ensure the legality and regularity of the co-financed operations, under the Commission’s supervision and final responsibility.

RESPONSIBILITIES OF MANAGING AND CERTIFYING AUTHORITIES

Managing authorities (often ministries or regional authorities in charge of a certain policy area) are responsible for selecting the individual projects to be included in the various OPs on the basis of previously agreed criteria. They also carry out first-level checks of these operations and the expenditure declared before the expenditure is certified by the certifying authority as legal and regular. Certifying authorities are generally part of the Ministry of Finance or internal control bodies under ministry authority.
THE ROLE AND RESPONSIBILITIES OF AUDIT AUTHORITIES

5. Audit authorities provide assurance to the Commission regarding the effective functioning of the management systems and internal controls for an OP (and, as a consequence, the legality and regularity of the expenditure certified) (see Annex II). They must be functionally independent from the bodies managing the funds.

6. Within the 27 Member States, 112 audit authorities have been set up for the 434 OPs approved as of the end of 2012 for the 2007–13 programming period (see Figure 1). In most cases the audit authorities are separate departments within State chancelleries, at Ministries of Finance (or internal control bodies under ministry authority), at other ministries or within Supreme Audit Institutions. Their role and responsibilities have been reinforced compared to those of the ex post control authorities in the 2000–06 programming period.

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4 63 of these 112 audit authorities are responsible for auditing OPs for the ERDF/CF as well as for the ESF in their Member State or region. These ‘multi-fund’ AAs account for 344 OPs (including ETC programmes) corresponding to 89 % of the total budget (EU and national public and private funding).

NUMBER AND TYPE OF AUDIT AUTHORITIES PER MEMBER STATE (2012)

<table>
<thead>
<tr>
<th>Member State</th>
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1 Including audit authorities exclusively responsible for European Territorial Cooperation (ETC) programmes.

Source: European Court of Auditors, 2012 survey.
7. An audit authority reports the findings of its systems audits and audits of operations to the managing and certifying authorities for the OP concerned (see Figure 2 and Annex II). Reports on systems audits are also submitted to the Commission. The managing authority has to decide whether financial corrections are to be applied as a result of these audits and/or whether alternative corrective action should be taken. If the audit authority considers that the managing authority has not taken appropriate corrective action, it must draw the Commission’s attention to the matter.

**FIGURE 2**

**MANAGEMENT AND CONTROL SYSTEM FOR OPs**

Source: European Commission.
If the Commission finds, based on its own work or the information reported by audit authorities, that a Member State has failed to remedy serious shortcomings in the management and control systems and/or to correct irregular expenditure which had been declared and certified, it may interrupt or suspend payments. If the Member State does not remedy any detected system failures or withdraw the irregular expenditure (which may be replaced by expenditure which is eligible), the Commission itself may apply financial corrections, leading to a net reduction in EU funding for the OP.

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**USE OF ERROR RATES REPORTED BY NATIONAL AUDIT AUTHORITIES IN THE COMMISSION’S ASSURANCE PROCESS**

The Directorates-General assess, for each OP, the reliability of the error rates reported by the audit authorities. Reliable error rates are meant to be representative for the OP (or group of OPs). If the Commission labels the audit authority’s error rate reliable, this means either that it can accept the rate or that it can recalculate it on the basis of additional information in the annual control report or obtained on the spot during fact-finding missions. In the case of unreliable error rates, the Commission applies a flat error rate (between 2% and 25%) in line with the results of its assessment of the functioning of management and internal control systems. This results in a validated ‘projected error rate’ for each OP.

Validated projected error rates are then used by the Directorates-General for Regional and Urban Policy and for Employment, Social Affairs and Inclusion to calculate average error rates for each Member State. The two Directorates-General have published those rates in their annual activity reports since 2011 and 2010 respectively.

The Commission also calculates a ‘residual error rate’ for each OP. This takes into account all financial corrections implemented at EU and national level since the start of the programming period and therefore has a multiannual character. Residual error rates are also reported in the annual activity reports.

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8. From 2010 to 2012, the Commission required the use of statistical sampling for populations comprising at least 800 items (see Guidance on treatment of errors disclosed in the annual control reports, COCOF 11-0041-01-EN, 7.12.2011, p. 11). From 2013 onwards, statistical sampling must be applied for populations comprising at least 150 items (see Guidance on sampling methods for Audit Authorities, COCOF 08/0021/03, 4.4.2013). Representative error rates may also be obtained from certain non-statistical sampling approaches.

9. Whereas projected error rates always relate to expenditure incurred during the previous year, residual error rates also take account of financial corrections implemented during the year covered by the relevant annual activity report.
AUDIT AUTHORITIES’ CONTRIBUTION TO THE COMMISSION’S ASSURANCE PROCESS

9. The information provided by audit authorities in their annual control reports, audit opinions and systems audit reports is one of the main sources underlying the Commission’s assessment, for each OP, of the legality and regularity of EU spending. When preparing their annual activity reports, the Directorates-General perform a detailed assessment of the work of national audit authorities, and in particular of the error rates reported by the audit authorities for each OP (or group of OPs). This information is examined against the Commission’s own audit results and other information at the disposal of the Directorates-General for each OP\(^{10}\) (see Box 2).

10. The Commission can choose to issue a full (or partial) reservation for an OP in its annual activity reports. As a first step, the Commission assesses the functioning of the management and control system, based on its monitoring of national authorities’ compliance with regulatory requirements and, where applicable, the status of corrective actions agreed with the Member State for the OP concerned. In a second step, the Commission assesses OPs which are not under reservation after this initial review. The validated projected error rate and the residual error rate calculated by the Commission are the main indicators used for this purpose (see Box 2). Since 2012, OPs have in general been subject to a reservation if the residual error rate exceeds the Commission’s 2% materiality threshold. No reservation is issued if the residual error rate is below 2%, even if the projected error rate is above 5% (see paragraph 40 and Annex III).

11. The error rates reported by audit authorities in Cohesion (and assessed and consolidated by the Commission for its assurance process) and those estimated by the Court in the context of its annual Statement of Assurance differ in the following respects:

- the error rates calculated by audit authorities are meant to be representative at the level of an OP (or group of OPs), while the Court’s error rates are calculated at the level of funds for all Member States;

- the Court’s error rate is based on a statistically representative sample of transactions at EU level, while, although audit authorities generally apply statistical sampling, they may also select audits of operations on the basis of non-statistical (and even non-representative) samples;

— there are methodological differences in quantifying the impact of the audit findings\(^{11}\);

— finally, the error rates reported by national audit authorities do not relate to the same period as those published by the Court\(^{12}\).

As a result, these annual error rates are not directly comparable. Meanwhile, the residual error rates calculated by the Commission are of a multiannual nature and take account of all the financial corrections implemented at EU and national level.

**THE ‘SINGLE AUDIT’ PRINCIPLE AS DEFINED IN ARTICLE 73**

12. In the context of the European Union budget, the term ‘single audit’ refers to a system of internal control and audit which is based on the idea that each level of control builds on the preceding one. ‘Single audit’ aims at preventing the duplication of control work and reducing the overall cost of control and audit activities at the level of the Member States and the Commission. It also aims at decreasing the administrative burden on auditees. The Commission (which holds ultimate responsibility for the implementation of the EU budget) is at the top of the ‘single audit’ pyramid.

13. In its Opinion No 2/2004, the Court set out a number of general principles for internal control systems to operate in accordance with the ‘single audit’ model (see *Annex IV*\(^{13}\)). The Court, as the external auditor of the EU, is not part of the Commission’s ‘single audit’ system.

14. In June 2005 the Commission presented its proposals for a ‘Community integrated control framework’ to achieve more effective and efficient internal control of EU funds\(^{14}\). In 2006, the Commission further developed this concept in its ‘Action Plan towards an Integrated Internal Control Framework’\(^{15}\), which had a significant impact on the design of internal control systems for the ERDF/CF and ESF as set out in the Regulations for the 2007–13 programming period. In particular, the Commission proposed:

— to minimise the duplication of control work (and to maximise the level of control which could be achieved with a given level of resources) by sharing control information so that one level of control could rely on the preceding level in the chain (‘single audit’ principle);

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\(^{11}\) The Commission (and the national audit authorities) quantify with a view to the financial corrections that are necessary given the irregularities found. This is particularly so for cases of non-compliance with the EU Directives and national public procurement laws (see 2012 Annual Report, Commission reply to paragraph 5.33 and Annex 1.1, paragraphs 9 to 11).

\(^{12}\) The error rates reported by audit authorities in their annual control reports for year \(n\) relate to expenditure certified to the Commission in year \(n-1\). The Court’s error rates for year \(n\) relate to expenditure in year \(n\).

\(^{13}\) Court of Auditors Opinion No 2/2004 on the ‘single audit’ model (and a proposal for a Community internal control framework) (OJ C 107, 30.4.2004, p. 1).


\(^{15}\) COM(2006) 9 final of 17 January 2006, in particular see Actions 5, 7, 9 and 13 to 16.
to introduce national control reports with a view to reinforcing accountability and providing an incentive for managers of EU funds to assess and improve their internal control systems;

to draw assurance from third-party independent audit bodies; and

to use common guidelines per policy area and ‘agreed upon procedures’ between EU and national level so as to ensure a consistent level of internal control.

15. For the 2007–13 programming period, the way the ‘single audit’ principles are to be applied in Cohesion is set out in Article 73 of Regulation (EC) No 1083/2006. This states that the Commission may reduce its own checks if it has obtained reasonable assurance that the OP’s management and internal control systems function effectively (see Box 3).

BOX 3

‘SINGLE AUDIT’ IN COHESION AS SET OUT IN ARTICLE 73

Article 73(2): ‘In determining its own audit strategy, the Commission shall identify those operational programmes for which the opinion on the compliance of systems under Article 71(2) is without reservations, or where reservations have been withdrawn following corrective measures, where the audit strategy of the audit authority is satisfactory and where reasonable assurance has been obtained that the management and control systems function effectively on the basis of the results of audits by the Commission and the Member State.’

Article 73(3): ‘For those programmes, the Commission may conclude that it can rely principally on the [audit authority’s audit] opinion […] with regard to the effective functioning of the systems and that it will carry out its own on-the-spot audits only if there is evidence to suggest shortcomings in the system affecting expenditure certified to the Commission in a year for which an [audit] opinion […] has been provided which contains no reservation in respect of such shortcomings.

Where the Commission reaches such a conclusion, it shall inform the Member State concerned accordingly. Where there is evidence to suggest shortcomings, it may require the Member State to carry out audits […] or it may carry out its own audits […]’
16. For those OPs to which Article 73 status has been granted, the Commission can then draw its assurance regarding the legality and regularity of EU spending, to a large extent, from the work of the audit authorities (‘single audit’ principle). Hence, ‘single audit’ status is the consequence of effective internal control arrangements for an OP. This provision in the Regulations draws largely on the example of the ‘contracts of confidence’ piloted during the 2000–06 programming period. However, OPs to which ‘single audit’ status has been granted by the Commission need not comply with any requirements over and above those already specified in the Financial Regulation or sectoral Regulations.

17. If the Commission considers that all necessary conditions are in place for an OP, a decision will be taken to notify the Member State in accordance with Article 73. In 2010, the Commission defined how the regulatory requirements for applying Article 73(2) were to be interpreted by its services. These internal rules (the ‘Article 73 roadmap’), were agreed in a working paper between the Directorates-General for Regional and Urban Policy and for Employment, Social Affairs and Inclusion. In 2012, the roadmap was amended, and additional criteria for granting Article 73 status were specified.

18. In the case of OPs with Article 73 status, the Commission relies on the audit opinion prepared by the corresponding audit authority. In particular, the Commission will carry out its own on-the-spot checks only if there is evidence to suggest shortcomings in the system affecting the legality and regularity of the expenditure which had been certified to the Commission for that year, unless the audit authority has adequately addressed these issues in its audit opinion.

19. Subject to the results of its monitoring, the Commission may decide to suspend (or withdraw) an OP’s ‘single audit’ status at any time. If the Commission decides to suspend (rather than withdraw) the application of Article 73, additional corrective action will have to be agreed with the Member State concerned.
AUDIT QUESTIONS

20. In the 2007–13 programming period, the Commission has increasingly relied on the information provided by national audit authorities and has put in place a comprehensive system for obtaining assurance regarding the legality and regularity of ERDF/CF and ESF expenditure.

21. Through this audit, the Court analysed the extent to which the Commission is able to rely, in the area of Cohesion, on the work of national audit authorities for its own assurance, and took stock of the Commission’s implementation of the ‘single audit’ model (as specified in Article 73) up to the end of 2012.

22. In particular, the Court examined whether the Commission has:
   — made proper use of the information provided by national audit authorities for its own assurance and when granting Article 73 status to OPs; and
   — ensured a consistent audit approach in Cohesion through its guidance and support of audit authorities.

The Court also analysed the costs of the reinforced audit arrangements introduced in the 2007–13 programming period.

PERIOD COVERED, EVIDENCE COLLECTION METHODS AND AUDIT CRITERIA APPLIED BY THE COURT

23. The period under examination was 2010 to 2012 and the audit involved inter alia:
   — an assessment of the Commission’s supervision and monitoring of national audit authorities and the way in which the information provided by them was used by the Commission in its annual activity reports;
   — a review of relevant information on the concept of ‘single audit’, on audit authorities and on the Commission’s procedures for granting Article 73 status;
an analysis of the Commission’s progress in granting Article 73 status to OPs and the budgetary impact thereof;

examination of a sample of 19 audit authorities for ERDF/CF and/or ESF in 15 Member States to assess their compliance with key regulatory requirements and their effectiveness;

a review of the Commission’s legislative proposal for the 2014–20 programming period as regards the role and responsibilities of national audit authorities;

an electronic survey of the 112 audit authorities for ERDF/CF and/or ESF to obtain their views on the Commission’s guidance and support, its supervision and monitoring activities, the effectiveness of the internal control system and the Commission’s proposals for the 2014–20 programming period. Around 97% of all the audit authorities responded to this survey;

an estimate of the ‘cost of control’ of audit activities for the 2007–13 programming period based on information provided by audit authorities in the survey; and

interviews with the heads of 36 audit authorities (or their representatives) in 17 Member States, following interest expressed through the survey.

24. The findings were examined against the relevant provisions in the Regulations for the 2007–13 programming period and the Commission’s own rules and guidelines with regard to granting Article 73 status. Account was also taken of the general principles applicable to an integrated internal control framework as set out in the Court’s Opinion No 2/2004 and in the Commission’s 2006 Action Plan, as well as the requirements of the international standards on auditing (ISAs) and the guidance notes addressed to audit authorities by the Coordination Committee of the Funds (COCOF).
DID THE COMMISSION MAKE PROPER USE OF THE INFORMATION PROVIDED BY NATIONAL AUDIT AUTHORITIES FOR ITS OWN ASSURANCE AND WHEN GRANTING ARTICLE 73 STATUS TO OPs?

25. For the Commission to draw assurance as to the legality and regularity of ERDF/CF and ESF expenditure from the work carried out by national audit authorities, the information provided by them must be comprehensive, reliable and accurate. This is particularly the case for ‘Article 73’ OPs, where the Commission would in principle rely on the audit opinion issued by the audit authority for its assurance process. The Court:

— reviewed how the information provided by audit authorities was presented in the annual activity reports of both directorates-general;

— examined specific risks associated with the way in which the error rates were calculated and reported by national audit authorities and with how financial corrections imposed at the national level were accounted for;

— verified for which OPs the Commission had taken decisions to grant Article 73 status, when those decisions were notified to the Member States and whether the minimum conditions for doing so had been fully in place; and

— assessed whether the Commission had put in place a robust monitoring strategy for Article 73 OPs.

THE COMMISSION RELIED ON THE INFORMATION PROVIDED BY AUDIT AUTHORITIES FOR ALMOST THREE QUARTERS OF ALL OPs IN 2012

26. Overall, in 2012, the Commission considered that 322 of the 434 OPs (74 %) required no reservation. These account for around 340 billion euro (69 %) of the total estimated budget (in terms of EU and national public and private funding) for the ERDF/CF and ESF. Annex III summarises how the 434 ERDF/CF and ESF OPs were classified by the Commission and by the two directorates-general for 2012.
27. The number of OPs without reservations increased significantly compared with 2011, when a total of 264 OPs (61%) were free of reservations (accounting for 260 billion euro (or 53%) of the total budget). This increase was almost entirely due to a larger number of ERDF/CF OPs for which the Directorate-General for Regional and Urban Policy no longer issued reservations in 2012.

28. In 2012, therefore, for a significant part of the Cohesion budget, the Commission considered that OP internal controls were functioning effectively and that EU spending was legal and regular.

RISKS ASSOCIATED WITH THE COMMISSION’S USE OF INFORMATION PROVIDED BY NATIONAL AUTHORITIES: ERROR RATES AND FINANCIAL CORRECTIONS

29. The Commission's assurance process in Cohesion relies on two main indicators: the projected error rates reported by national audit authorities (as validated by the Commission) and the residual error rates calculated by the Commission itself (see paragraph 10 and Box 2). This requires both the error rates reported by national audit authorities and the information on financial corrections implemented at national level to be accurate and reliable. Moreover, the Commission must make appropriate use of this information so that its assessment properly reflects the situation for each OP.

INSUFFICIENT ACCURACY AND RELIABILITY OF THE ERROR RATES REPORTED FOR SEVERAL OF THE AUDIT AUTHORITIES EXAMINED BY THE COURT

30. Audit authorities which are not effective in checking the legality and regularity of EU spending are obviously a major impediment to implementation of the ‘single audit’ model in Cohesion. The Court’s examinations of audit authorities between 2010 and 2012 highlighted shortcomings in the calculation (and reporting) of error rates in a number of cases (see Box 4). Therefore, doubts remain as to the accuracy and reliability of the error rates reported by several audit authorities. The risk that audit authorities may under-report problems was also noted by the Commission’s Internal Audit Service in a 2013 report.

23 171 ERDF/CF OPs (54 %) and 93 ESF OPs (79 %).

31. The Court notes that the Commission may interrupt or suspend payments if audit authorities under-report problems for OPs. However, there is no provision in the Regulations for the 2007–13 programming period for the Commission to impose targeted net financial corrections on OPs in respect of which the audit authorities repeatedly under-report problems.

**COURT’S OWN EXAMINATION OF AUDIT AUTHORITIES: MAIN FINDINGS**

The Court’s examinations of 19 audit authorities between 2010 and 2012 showed that:

— seven audit authorities applied a sampling approach which was not in line with the regulatory requirements and/or the Commission’s guidance, or the sample of operations to be audited was incorrectly drawn;

— for 12 audit authorities, the Court detected irregularities, either in relation to issues which had not been checked (often due to differences in the audit scope and approach) or where the significance of the finding had been understated by the audit authority for at least one of the audits of operations re-performed by its own auditors; and

— for five audit authorities, the Court found cases where the audit authority had unduly omitted errors from the calculation of the error rate or otherwise miscalculated the rate. In these cases, the differences detected by the Court were significant (i.e. augmenting the projected error rate by more than 0.5 %) and/or would have had an impact on the audit opinion.

The Court concluded from its examination of 19 audit authorities between 2010 and 2012 that eight were globally ‘effective’. Nine were rated as ‘partially effective’ and two were ‘not effective’.

Five of the 19 audit authorities examined by the Court had significantly under-reported the error rates for OPs in their annual control reports. This led to insufficient financial corrections being imposed by managing and certifying authorities.

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25 2010 Annual Report, Chapter 4, Annex 4.2; 2011 and 2012 Annual Reports, Chapter 5, Annex 5.2.
THE COMMISSION’S SCOPE FOR VALIDATING THE ERROR RATES DISCLOSED IN ANNUAL CONTROL REPORTS IS LIMITED

32. Each year, the Commission conducts a desk review of annual control reports, which provide summaries of the results of audit authorities' system audits and audits on operations in relation to the expenditure certified to the Commission during the previous year. The Court’s audits showed, however, that the Commission has limited scope to verify the calculation of error rates during these desk reviews and, where necessary, make adjustments. This has already been noted by the Court in previous years, and is due to the fact that audit authorities are not required to submit detailed information about their audits of operations to the Commission (such as audit reports).

33. The summary information disclosed in annual control reports does not permit the recalculation of error rates or verification that the sampling method set out in the audit authorities' audit strategy has actually been complied with. The Commission would normally only carry out limited plausibility checks of the reported error rates (see paragraph 65, first and second indents). The additional information necessary for more effective checks is not requested systematically, but only on a case-by-case basis if the desk reviews identify issues which need to be clarified. Where the Commission had such information, the Court’s checks showed that its assessment of the error rates reported by audit authorities was generally effective.

34. The Court’s analysis of the 2012 annual activity reports of the Directorates-General for Regional and Urban Policy and for Employment, Social Affairs and Inclusion in respect of 138 ERDF/CF and ESF OPs (based on the information available at the Commission and additional data requested from audit authorities) showed that:

— for 51 of the 138 OPs reviewed the Commission did not have sufficient information to accept (or recalculate) the error rates reported by the audit authorities. This included cases where the audited expenditure stated in the annual control report did not fully correspond to OP spending for the year or where an error rate was not accurately calculated by the audit authority; and

— for five of the 138 OPs examined (including one Article 73 OP), the residual error rate recalculated by the Court was above the Commission’s materiality threshold of 2%. This should have led to additional reservations by the Commission in respect of the ERDF/CF OPs concerned.

26 2011 Annual Report, paragraph 5.50; 2012 Annual Report, paragraph 5.52.


28 2012 Annual Report, paragraphs 5.52 and 6.34.

29 2012 Annual Report, paragraphs 5.52 and 5.57.
THE ROBUSTNESS OF THE COMMISSION’S CALCULATION OF RESIDUAL ERROR RATE IS AT RISK

THE ERROR RATES USED BY THE COMMISSION WHEN CALCULATING RESIDUAL ERROR RATE ARE NOT SUFFICIENTLY RELIABLE

35. When calculating the residual error rate for an OP (or a group of OPs), the Commission takes account of the annual projected error rates for all years in which interim or final payments were made (see Box 2). In 2010, most audit authorities reported error rates for the first time, with a significant number reporting error rates of 0 %, very low error rates or no error rates at all (in relation to 2009 expenditure). The Commission also identified significant shortcomings in the way in which audit authorities had carried out their audits of operations (see also paragraph 45). As a result, the Directorate-General for Regional and Urban Policy chose not to rely on these rates in 2010, instead using a set of flat rates for its calculation of the risk to 2010 payments. The Court found that around a third of the rates considered to be unreliable in 2010 were subsequently used by the directorate-general when calculating multiannual residual error rates in 2012. For the remaining OPs, the directorate-general validated adjusted rates for 2010 that had been reported by audit authorities in 2011 and 2012. Generally speaking, these rates, which the Commission validated in 2012, did not differ significantly from those reported in 2010. The Court notes, however, that the directorate-generals’ estimate of the payments at risk in 2010 would have been above the Commission’s 2 % materiality threshold if the validated error rates had been used instead of the flat rates (2,8 % instead of the 0,8 % reported in the 2010 Annual Activity Report)\textsuperscript{30}.

36. Moreover, for only around half of the ERDF/CF OPs (46 % in 2011 and 55 % in 2012) did audit authorities report error rates which were statistically representative for the OP as a whole\textsuperscript{31}. However, even where an OP has a non-representative error rate, the Commission takes account of all financial corrections when calculating the corresponding residual error rate. The Court considers that this practice is not appropriate. If the error rate is not representative of the population as a whole, the residual error rate should only take account of those financial corrections which were implemented for the sample audited (and to which the error rate relates).

\textsuperscript{30} 2010 Annual Activity Report of DG Regional and Urban Policy, p. 69.

\textsuperscript{31} These OPs accounted for 54 % of the total budget in 2011 and 73 % in 2012.
The reliability of the Commission’s calculation of residual error rate depends to a large extent on the accuracy of Member States’ information on financial corrections implemented at national level and how this information is taken into account by the Commission (see paragraph 29). Accounting for financial corrections is however a complex task: they are made at different stages of programme implementation and as a result of a multitude of control and audit activities (by national and EU bodies). At national level, financial corrections can be imposed by managing and certifying authorities through withdrawals and recoveries (see Box 5).

**Box 5**

**FINANCIAL CORRECTIONS AT MEMBER STATE LEVEL IN COHESION**

Financial corrections aim at protecting the EU budget from the burden of erroneous or irregular expenditure. According to the financial regulation, amounts incorrectly paid are to be recovered\(^{32}\). For expenditure subject to shared management, preventing or detecting and correcting payments incorrectly made is the primary responsibility of Member States\(^{33}\). In Cohesion, the regulations also require certifying authorities to report annually on all financial corrections implemented (i.e. withdrawals and recoveries), and also on pending recoveries and unrecoverable amounts\(^{34}\).

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\(^{32}\) Article 78(3) of the financial regulation.

\(^{33}\) Recital 65, Article 61 and Article 70 of Regulation (EC) No 1083/2006.

\(^{34}\) Article 20 of Regulation (EC) No 1828/2006 and guidance note to certifying authorities on reporting on withdrawn amounts, recovered amounts, amounts to be recovered and amounts considered irrecoverable, applicable to programming period 2007–13 and the remainder of the 2000–06 programming period, COCOF 10/0002/02/EN, 17 March 2010.
38. The Court considers that there is also a risk of the Commission underestimating the residual error rate where it has limited assurance of the reliability and accuracy of a Member State’s information on financial corrections. This is mainly due to the following aspects:

— Timing: the certifying authority reports on financial corrections for a given year before the end of March of the following year (n+1). This is the same deadline for directorates-general to present their annual activity reports. As a result, provisional information on financial corrections is requested from certifying authorities. The Court considers that the information in the previous (definitive) report should be used instead when calculating residual error rate. This would also result in a better match with the period for which the projected error rate is calculated and for which reliable information on the financial corrections implemented is available (end of year n-1).

— Double counting: Member States report financial corrections without specifying the source (i.e. whether they are based on managing and certifying authorities’ own checks or on audits carried out by audit authorities). However, the directorates-general are unable to isolate withdrawals and recoveries which result from national audit authorities’ own audit work35. This makes it impossible for the Commission to verify whether audit authorities have reduced their projected error rates by taking account of financial corrections implemented after certification of expenditure to the Commission. The Court found several cases where financial corrections (withdrawals) taken into account by the Commission for the residual error rate calculation were related to expenditure decertified by the Member State before the sample was drawn or where the irregular expenditure in the sample was incorrectly reduced by financial corrections.

— Inclusion of pending recoveries: the Commission’s calculation takes account of pending recoveries reported by Member States. This information on financial corrections is by definition uncertain, since these recoveries have not yet been implemented by the end of year n.

35 Article 20(2) of Regulation (EC) No 1828/2006, Annex XI: The annual statement specifies the types of financial corrections (i.e. withdrawn and recovered amounts, pending recoveries and irrecoverable amounts), but not their origin.
— Adjustment of error rates in subsequent years with no corresponding adjustment in financial corrections: audit authorities can adjust their estimates of error rates in subsequent years. This may occur if an error is no longer maintained (or assessed differently) in view of additional information obtained by the audit authority after submission of the annual control report. The adjusted rate is taken into account by the Commission, resulting in a reduction in the residual error rate. However, the Commission does not verify whether any financial corrections made in relation to irregularities which may already have been reported by the certifying authority are subsequently also adjusted.

INDICATIONS THAT THE RESIDUAL ERROR RATE MAY BE UNDERSTATED IN A NUMBER OF CASES

39. For a significant number of OPs, the Court’s analysis indicates that the financial corrections taken into account for the calculation of residual error rate may be over-estimated (or alternatively that the projected error rate was understated): in 2011, 33 ERDF/CF OPs and 22 ESF OPs (in 11 Member States) had a negative residual error rate. In other words, the multiannual financial corrections taken into account by the Commission when calculating an OP’s residual error rate were higher than the spending affected by error (as extrapolated from the statistically representative error rate reported by the national audit authority). In 2012, this was the case for 53 ERDF/CF OPs in 16 Member States. This effect applies across the board to all ERDF/CF and ESF OPs, but it can be demonstrated only in the case of OPs with negative residual error rates.

40. The Court emphasises that the reliability of the residual error rate is an important element in the Commission’s assurance process. In a number of cases the Commission’s decision not to issue a reservation for an OP is justified by the residual error rate’s being below the 2 % materiality threshold (see paragraph 10). In 2012, this was the case for 67 ERDF/CF OPs and 29 ESF OPs for which no reservations were made despite a validated projected error rate above 2 % (see Annex III).
LIMITED TAKE-UP OF THE OPTION TO APPLY THE ‘SINGLE AUDIT’ PROVISIONS, DELAYS IN GRANTING ARTICLE 73 STATUS AND MINIMUM CONDITIONS NOT ALWAYS IN PLACE

LIMITED TAKE-UP OF THE OPTION TO GRANT ARTICLE 73 STATUS BY THE END OF 2012

41. As at December 2012, the Commission had granted Article 73 status to 61 of the 434 OPs in 12 of the 27 Member States (see the Table): 51 ERDF OPs in 10 Member States and 10 ESF OPs in five Member States.

42. This corresponds to around 14 % of the 434 OPs for the 2007–13 programming period, the share of Article 73 OPs being higher for the ERDF/CF (16 %) than for the ESF (9 %). As at the end of 2012, no Article 73 status had been granted to cross-border European Territorial Cooperation (ETC) OPs.

43. These 61 Article 73 OPs account for a total estimated budget (EU and national public and private funding) of 75 839 million euro for the 2007–13 programming period. This corresponds to around 16 % of the total budget of 490 654 million euro (see Table and Annex I). This share is significantly smaller than for OPs (69 % of the total budget) in respect of which the Commission issued no reservations in 2012 (see paragraph 26).

| TABLE |


<table>
<thead>
<tr>
<th></th>
<th>ERDF/CF</th>
<th>ESF</th>
<th>Total</th>
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<tr>
<td>Number of OPs</td>
<td>317</td>
<td>117</td>
<td>434</td>
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<td>— of which Article 73</td>
<td>51</td>
<td>10</td>
<td>61</td>
</tr>
<tr>
<td>— in %</td>
<td>16 %</td>
<td>9 %</td>
<td>14 %</td>
</tr>
<tr>
<td>Total budget (in million euro)</td>
<td>374 444</td>
<td>116 210</td>
<td>490 654</td>
</tr>
<tr>
<td>— of which Article 73</td>
<td>69 545</td>
<td>6 294</td>
<td>75 839</td>
</tr>
<tr>
<td>— in %</td>
<td>19 %</td>
<td>5 %</td>
<td>16 %</td>
</tr>
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FIRST DECISIONS TO GRANT ARTICLE 73 STATUS TAKEN IN MARCH 2012

44. Granting Article 73 status to an Operational Programme will have an effect on the Commission’s supervision from the year following the notification until the close of the programming period. Therefore, the earlier in the programming period ‘single audit’ status can be granted to OPs, the greater will be the impact.

45. In the Article 73 roadmap, the Commission initially anticipated that the first Article 73 decisions could be taken during 2011. This proved however to be overly ambitious:

— For a number of OPs, Member States experienced significant difficulties during 2009/2010 in presenting robust compliance assessments to the Commission, which delayed the Commission’s acceptance of these documents. This process was prioritised by Member States and the Commission in the early years of the 2007–13 programming period.

— In addition, for a large number of audit authorities, no audits of operations were carried out until 2009/2010, and the results of these audits were reported in the 2010 annual control reports. However, the Commission did not consider these first reported error rates to be sufficiently robust for an assessment as to whether Article 73 could be granted to OPs (see paragraph 35).

46. Article 73 status was first granted to OPs in March 2012, following the audit authorities’ submission of the 2011 annual control reports. Thus, the ‘single audit’ model was applied for the first time as late as the sixth year of the 2007–13 programming period. This illustrates the difficulties in effectively applying Article 73 as specified in the regulations.

38 European Commission, Directorate-General for Employment, Social Affairs and Inclusion, Roadmap for the implementation and for the monitoring of the correct implementation of the “single audit” principle (final version agreed with Directorate-General for Regional and Urban Policy), 13.10.2010.

COMPLIANCE WITH ARTICLE 73 CONDITIONS TESTED BY THE COURT

47. Based on the provisions of Article 73 of the regulations, and taking account of the key conditions specified in the Commission's internal rules in 2010 and 2012 (see paragraphs 15 and 17), the Court considers that the following minimum requirements need to be fulfilled for an OP to qualify under Article 73:

— the audit strategy and compliance assessment must have been accepted by the Commission;

— the OP’s internal controls must function effectively, and in particular the multiannual residual error rate must be below the Commission’s materiality threshold of 2 %;

— the results of the Court’s audits should be considered, in particular where significant weaknesses in the OP’s internal controls have been identified; and

— the audit authority must have been rated ‘effective’.

48. Overall, the Court’s verifications showed that 46 of the 61 Article 73 OPs satisfied all these conditions (see Box 6). Taken together, these OPs account for around three quarters of the total budget of all Article 73 OPs.
OVERVIEW OF THE RESULTS OF THE COURT’S TESTING OF ARTICLE 73 CONDITIONS (2012)

The Court found that the Commission had accepted the audit authorities’ audit strategy and compliance assessment documents (report and opinion) for all 61 Article 73 OPs, generally in 2008 and 2009.

However, for a number of OPs, the tests showed that other conditions for granting Article 73 status were not fully in place.

(a) Insufficient information as to whether the internal controls were functioning properly. In particular, the Court found that:

— for 10 ERDF and ESF OPs in 2011 and 15 OPs in 2012, the Commission validated a projected error rate above the 2 % materiality threshold. In these cases, Article 73 status should only have been granted if at the same time the residual error rate for each of the OPs concerned was below 2 %\(^{40}\). For six ERDF OPs, this was only achieved because the Commission grouped them together when calculating the residual error rate. However, Article 73 status is supposed to be granted to a specific OP and not a group of OPs. The Court therefore considers that the Commission cannot use a combined residual error rate in this way;

— in the case of another ERDF OP, the Commission had issued a partial reservation in March 2012. In November 2012, the Commission assessed that corrective action had been taken for this reservation to be lifted. At the same time the OP was granted Article 73 status, before checks were made of the 2012 annual control report for the OP, which was submitted shortly afterwards.

(b) The error rate reported by the audit authority was not statistically representative and therefore the Commission did not have a sufficiently robust basis for deciding whether to grant Article 73 status:

— according to the regulation the size of the sample must be sufficient to enable the audit authority to draw valid conclusions regarding the effective functioning of the system. For one ERDF and two ESF OPs, the audit authorities had taken a sample in line with the Commission’s guidance. Each sample was however too small for the error level to be extrapolated to the population as a whole. As a result, the error rates reported by the audit authorities cannot be considered representative of the OPs (or group of OPs) examined and therefore do not permit a conclusion as to the effective functioning of the OPs’ management and control systems;

— for two ERDF OPs, the sampling population for the 2012 audits of operations, used for sampling in March 2012, did not include projects corresponding to at least a quarter of the expenditure certified to the Commission. When granting Article 73 status in June 2012, the Commission was not aware that the audit authority had opted for a sampling approach which was in breach of the regulation;

\(^{40}\) In principle, both rates should be below the Commission’s materiality threshold of 2 % (see **Box 2**). However, this requirement is more important for the residual error rate, which takes account of the projected error rates and multiannual financial corrections since the start of the programming period (see paragraphs 35 to 40). If this rate is above the 2 % threshold, it indicates that the internal controls are not sufficiently effective in detecting and correcting irregularities.
— for one ESF OP, in accordance with the Commission’s guidance for very small OPs, the audit authority had taken a sample of only two operations in 2011\(^\text{41}\). Again, the error rate cannot be considered representative.

(c) Weaknesses in an OP’s internal controls were detected by the Court through its own audits of operations\(^\text{42}\). This was the case for two Article 73 OPs.

(d) Two of the five audit authorities in charge of Article 73 OPs were rated ‘partially effective’ by the Court\(^\text{43}\).

\(^{41}\) The EU co-financing for this OP exceeded 40% of the total public expenditure. As a result, the Commission could not apply Article 74 of Regulation 1083/2006 on proportional control arrangements, which would also have allowed it to rely on the work of the audit authority for this OP (see Annex IV).

\(^{42}\) The Court’s sample of OPs audited under its annual Statement of Assurance since 2009 has included 16 of the 51 ERDF Article 73 OPs and two of the 10 ESF Article 73 OPs.

\(^{43}\) Overall, by the end of 2012, 21 audit authorities were responsible for auditing Article 73 OPs, five of which had also been examined by the Court between 2010 and 2012: Belgium (Wallonia) — Cellule Audit de l’Inspection des finances pour les fonds européens (CAIF); Spain — Intervención General de la Administración del Estado (IGAE); Malta — Internal Audit and Investigations Department (IAID); Poland — Generalny Inspektor Kontroli Skarbowej; Portugal — Inspeção-Geral de Finanças (IGF).
THE MONITORING ARRANGEMENTS FOR ARTICLE 73 OPs NEED TO BE STRENGTHENED AND ‘SINGLE AUDIT’ STATUS SHOULD BE REVOKED IF MINIMUM CONDITIONS ARE NO LONGER MET

COMMISSION'S MONITORING APPROACH FIRST DEVELOPED IN 2010

49. In the case of Article 73 OPs the Commission would in principle rely on the audit opinion issued by the audit authority. For this to work, however, the Commission must be certain that the quality of the audit work by the audit authority concerned continues to be up to standard and that the information on the OP’s projected error rate and financial corrections is reliable.

50. In 2010, the Commission set out its strategy for monitoring audit authorities in the Article 73 roadmap. In this working paper, the Directo rates-General for Regional Policy and for Employment, Social Affairs and Inclusion agreed to:

- undertake a desk review of the annual control reports, annual opinion and system audits received for each Article 73 OP (as for any other OP); and
- maintain close bilateral contacts with each audit authority through meetings and joint audit engagements (or Commission representa tives participating as observers in audits carried out under the responsibility of the national audit authority).

51. The ISAs on using the work of other auditors state that the Commission should carry out a review of an audit authority’s working papers when relying on their work. In addition, the ISAs require some audits to be re-performed.
For Article 73 OPs, the Commission no longer intended to carry out its own examination of national managing and certifying authorities. Instead, the Commission relied on the systems audits carried out by the audit authorities. Similarly, the Commission no longer carried out its own examinations of audit authorities or its own on-the-spot audits of operations.


According to the Article 73 roadmap, the Commission could impose action plans on an audit authority; conduct systems audits to verify the degree of non-compliance of systems, and audits of operations to measure the impact of deficiencies; interrupt or suspend payments to the OP; or apply financial corrections.

In 2013, when examining the 2012 annual control reports, the Commission verified for the first time whether the conditions for granting Article 73 status were still in place for OPs (and audit authorities) to which ‘single audit’ status had been granted in 2012. The Court notes that the Commission initiated corrective actions for three audit authorities in charge of four ERDF OPs where the Court had reported that the ‘single audit’ conditions were not complied with as of the end of 2012 (see paragraph 48 and Box 6).
56. The 'single audit' concept will also be relevant for the closure of the 2007–13 programming period. Audit authorities will have until the end of 2015 to submit an annual control report and must prepare a closure declaration no later than 31 March 2017, supported by a final control report (see Annex II). Where Article 73 status has been granted to an OP, the Commission will be able to draw assurance that the final payment is legal and regular from the work of the audit authority rather than carrying out its own detailed checks. The Court therefore considers that, for programme closure to be effective (which depends on the quality of the information provided by audit authorities), the Commission will need to have developed a sufficiently robust monitoring of audit authorities' work by that time.

DID THE COMMISSION ENSURE A CONSISTENT AUDIT APPROACH ACROSS ALL OPs THROUGH ITS GUIDANCE AND SUPPORT FOR AUDIT AUTHORITIES?

57. The 'single audit' model can only be implemented effectively if audit authorities apply a consistent audit approach so that audit results are comparable between Member States, funds and OPs and over time. The Court verified whether the Commission had:

— provided appropriate methodological guidance to audit authorities for their work in accordance with the regulations;^49^;

— promoted the exchange of good practices with and between audit authorities; and

— organised training activities addressing the specific needs of audit authorities.

In this context, the Court also asked how the Commission’s capacity-building activities are perceived by audit authorities.

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Audit authorities should take account of internationally accepted audit standards (IAAS)\(^5\). In particular, the regulations refer to the ISAs, the professional standards issued by the Institute of Internal Auditors and INTOSAI audit standards. The Court notes that these standards, although they have some degree of similarity, are not identical. In addition, the regulations do not formally require that audit authorities comply with IAAS. Only half of the respondents (52\%) to the Court’s survey considered the extent to which the regulations set methodological requirements for audit authorities to be appropriate.

The Commission provides additional guidance material to support audit authorities in their operational work. This is generally done by means of ‘COCOF guidance notes’ (see Box 7).

The Coordination Committee of the Funds (COCOF) is the committee of Member State representatives set up under Article 103 of Regulation (EC) No 1083/2006 to provide advice to the Commission on the implementation of the ERDF, ESF and CF. The Commission chairs COCOF meetings and provides a secretariat.

COCOF plays a particular role in relation to the Commission’s guidance on all methodological and technical aspects where the regulations are silent. The Commission discusses draft versions with COCOF before finalising and issuing guidance notes.

The guidance notes serve as recommendations with practical examples and information, without being legally binding or limitative. All guidance notes include a legal disclaimer in this respect.
SOME GUIDANCE TO AUDIT AUTHORITIES ISSUED LATE

60. The results of the Court’s survey showed that a majority of respondents considered that at least part of the guidance was not provided in due time. 15% of audit authorities considered that guidance was generally late, and 58% considered that guidance was partly late.

61. The survey results and the interviews carried out with heads of audit authorities revealed delays in particular for the issues covered by the following COCOF and other guidance notes: the model audit approach for financial engineering instruments (issued in July 2011) and the treatment of errors disclosed in annual control report (issued in December 2011). In addition, the second of these guidance notes was applied retroactively by the Commission when assessing the work of audit authorities (see Box 8).

62. The Court also observed cases of good practice where guidance was provided in time. This was in particular the case of the COCOF guidance on a common methodology for the assessment of management and control systems in the Member States (2007–13 programming period), COCOF 08/0019/01, 6.6.2008; Guidance note on the audit strategy (under Article 62 of Regulation (EC) No 1083/2006), COCOF 07/0038/01, 6.8.2007; Guidance note on the ‘compliance assessment’ exercise (under Article 71 of Regulation (EC) No 1083/2006), COCOF 07/0039/01, 6.8.2007.

BOX 8
RETROACTIVE APPLICATION OF COCOF GUIDANCE NOTE BY COMMISSION

The COCOF guidance on the treatment of errors disclosed in the annual control report, issued in December 2011, was applied retroactively to the 2011 annual control reports presented by audit authorities in the same month.

The adjustments that audit authorities were required by the Commission to make to their annual control reports in line with the guidance note caused duplication of work and further delayed the final versions of annual control reports.

SIGNIFICANT PROGRESS ON PRESENTING COMPREHENSIVE AND CLEAR GUIDANCE MATERIAL SINCE THE START OF THE PROGRAMMING PERIOD

63. The Court found that the COCOF guidance notes cover a wide range of issues which are relevant for the work of audit authorities. The survey also showed that a majority of respondents think that the set of guidance notes is comprehensive (75 %) and consider the level of Commission guidance to be appropriate (60 %).

64. The Commission’s guidance is generally accepted and taken into account by audit authorities in their work, despite its non-binding character. Through the Court’s survey, more than 90 % of audit authorities indicated that they apply the COCOF guidance notes fully (or with some exceptions). This was also confirmed by the interviews with heads of audit authorities.

65. Overall, the Court considers that the Commission has made significant progress, since the start of the programming period, on providing guidance material which contributes to better consistency in audit authorities’ approaches and methodologies. In particular, in April 2013, the Commission issued substantially revised guidance on statistical sampling\(^2\). This guidance must be applied by audit authorities from 2013 onwards and should help to address the shortcomings previously observed in this respect (see Box 4).

SPECIFIC WEAKNESSES IDENTIFIED IN RELATION TO THE COMMISSION’S GUIDANCE ON ANNUAL CONTROL REPORTS

66. As regards the provisions on annual control reports and audit opinions specified in the regulations, the Court considers that the Commission needs to clarify its guidance so that the information reported by audit authorities can be checked effectively (see paragraphs 32 to 34)\(^3\). This concerns in particular:

— information on which operations (i.e. projects or payment claims and amounts declared) make up the sample audited by the audit authority. This would allow the Commission to understand on what basis the error rate reported in the annual control report has been calculated;

\(^2\) Guidance on sampling methods for Audit Authorities, COCOF 08/0021/03, 4.4.2013.

\(^3\) Guidance note on Annual Control Reports and Opinions, COCOF 09/0004/01); see also Annex VI to Regulation (EC) No 1828/2006.
— details concerning the errors found (i.e. information regarding operations affected by error and error amount). Based on this information, the Commission could check more effectively the accuracy and reliability of the error rate reported in the annual control report;

— disclosure of the audit authority’s multiannual assessment of how the internal controls work, rather than just the current snapshot of audits carried out during the period covered by the annual control report. This could also provide a better basis for assessing whether appropriate corrective action has been taken and whether the audit authority’s audit strategy needs to be adjusted; and

— information in relation to events occurring subsequent to the period covered by the annual control report (which could lead to a different assessment of the effectiveness of internal controls). The Commission has not yet provided guidance on which (and how) cases that may have an impact on whether the audit authority needs to issue a qualified (or adverse) audit opinion are to be reported in the annual control report. Currently, only a few audit authorities report these issues at all.

67. The Court’s analysis also showed that a number of provisions in the Regulations (or in the COCOF guidance notes) in relation to the audit opinion differ from what is specified in the ISAs. This is the case, for example, of the wording (and types) of audit opinions which are to be used; the period covered by audit opinions; the discrepancy in terminology between the Regulation and ‘International Federation of Accounts’ (IFAC) standards; uncorrected misstatements; and clarification of management and auditor responsibility in the audit opinion.

EXCHANGE OF GOOD PRACTICES WITH AND BETWEEN AUDIT AUTHORITIES PROMOTED BY THE COMMISSION

68. The regulations require the Commission and audit authorities to meet on a regular basis, and at least once a year, in order to examine the annual control reports and audit opinions and exchange views on other issues relating to the management and control of OPs. The Commission also organises ad hoc technical meetings and the annual meeting of the ‘Homologues Group’.

54 Article 73(1) of Regulation (EC) No 1083/2006.

55 The Homologues Group is an informal working group composed of representatives of national audit authorities and the audit directorates of the Directorates-General for Regional and Urban Policy, for Employment, Social Affairs and Inclusion and for Maritime Affairs and Fisheries.
69. Audit authorities are generally satisfied with the Commission’s capacity-building activities and support. 68% of the respondents to the Court’s survey consider that the Commission effectively supports audit authorities in their work. The survey and interviews with heads of audit authorities indicate, however, the need for more Commission support in specific areas. For example, there is only limited information available for benchmarking audit authorities in terms of their organisational set-up, the resources allocated by them to their different activities and the good practices some of them have put in place. In 2012, the Directorate-General for Regional and Urban Policy set up a special skills centre for administrative capacity-building56.

THE COMMISSION SUPPORTS AUDIT AUTHORITIES THROUGH SPECIFIC TRAINING

70. The Commission has carried out training activities to provide additional guidance for national audit authorities and promote good practices. These training activities, which mostly took place during the early phase of the programming period, have focused on specific issues (such as changes in the regulatory framework, compliance assessments, public procurement, annual control reports and audit opinions).

71. Overall, for the period audited, the Court estimates that around a fifth of all staff working for audit authorities have participated in training of this sort. High participation rates have been observed in particular in Bulgaria, the Czech Republic, Poland, Romania, Slovakia and Spain.

72. In the Court’s survey, the Commission’s training activities (which are provided in addition to training measures organised at national level) were rated very positively. Moreover, a third of the respondents expressed a desire for more (and more frequent) training by the Commission. This was also confirmed during interviews with audit authority representatives.

WHAT ARE THE COSTS OF THE AUDIT ARRANGEMENTS INTRODUCED IN THE 2007–13 PROGRAMMING PERIOD?

73. The ‘single audit’ concept aims at preventing the duplication of control work and reducing the overall cost of control and audit activities at Member State and Commission level, while also decreasing the administrative burden on auditees (see paragraph 11).

74. According to information presented by the Commission in 2011, the overall administrative cost for the implementation of OPs for the 2007–13 programming period is 3.2% of the total budget. Based on this information, the ‘cost of control’, which relates to the verification, certification and audit activities carried out by national authorities, accounts for 0.9% of the total budget (i.e. less than 30% of the total administrative cost). Around one fifth of the ‘cost of control’ is related to ‘programme audit’ (the work of national audit authorities).

75. In accordance with Article 46 of Regulation 1083/2006, the EU budget provides technical assistance to Member States (in most cases up to 4% of the total allocation to OPs from the Funds). The Court notes that the ‘cost of control’ is eligible under technical assistance.

76. Based on the information provided by audit authorities in 2012 (and reconfirmed in 2013), the Court estimates that the overall cost of running the 112 audit authorities increased between 2010 and 2012 from around 110 million euro to 130 million euro per year. For the entire 2007–13 programming period, the total ‘cost of control’ relating to audit authorities amounts to around 860 million euro. This corresponds to 0.2% of the total budget for the ERDF/CF and ESF and is broadly in line with the Commission’s own estimate.


58 In 2011, the Contact Committee of the EU’s Supreme Audit Institutions (SAIs) presented a report on the overall ‘cost of control’ in the Cohesion policy area based on a parallel audit of 12 SAIs. This report analysed the administrative and control costs of managing, certifying and audit authorities for the first years of the current programming period (2007 to 2009) on the basis of a sample of 34 ERDF/CF and 7 ESF OPs (see http://eca.europa.eu/portal/pls/portal/docs/1/11370726.PDF).
77. Around 2 600 full-time staff are employed by national audit authorities. The Court’s analysis of the survey data also shows that the workload has increased during the current programme period: between 2010 and 2012 staff numbers rose by around 10 %. According to the interviews with heads of audit authorities, this can mainly be attributed to the additional work carried out by audit authorities since 2010 on audits of operations and the increasing use of statistically representative (and therefore larger) samples.

78. In the 2014–20 programming period, audit authorities will be given additional responsibilities within an OP’s internal control system. In particular, the audit authority will be expected to:

— examine the managing authority’s annual management declaration (including a summary of its checks and controls) and issue an audit opinion as to whether the accounts prepared by the certifying authority are complete, accurate and true; and

— express an opinion on the sound financial management of each OP.

These additional responsibilities are also specified in the Financial Regulations for the period beginning 2014 and will further increase the ‘cost of control’. In this respect, the Court would observe that internal control systems require an appropriate balance between the cost of checks in a particular budgetary area and the benefits those checks bring in terms of limiting the risk of loss and irregularity to an acceptable level.

For the 2007–13 programming period, the Member States and the Commission reinforced the internal control arrangements in Cohesion by, among other things, setting up national audit authorities as an additional layer of internal control. These audit authorities ensure that the Commission has at its disposal better and more comprehensive information on the legality and regularity of expenditure for each OP (or group of OPs).

The Commission has put in place a system for obtaining assurance as to the legality and regularity of ERDF/CF and ESF expenditure from the work of national audit authorities. The design of this system is generally in line with the ‘single audit’ principles set out by the Court in its Opinion No 2/2004. The Court also takes note of the Commission’s close cooperation with national audit authorities and improvements in the form of a more consistent level of internal control of the 434 ERDF/CF and ESF OPs in the 27 Member States.

The ‘single audit’ principles specified in Article 73 of Regulation (EC) No 1083/2006 are a precondition for the effectiveness of shared management in Cohesion: checks by national audit authorities must be effective and, at the same time, must show that the management systems and internal controls in place function properly. In other words, in addition to the audit authority, all parts of an OP’s internal control system must work effectively.

The Court’s main findings are summarised below.

**DID THE COMMISSION MAKE PROPER USE OF THE INFORMATION PROVIDED BY NATIONAL AUDIT AUTHORITIES WHEN GRANTING ARTICLE 73 STATUS TO OPS?**

By the end of 2012, the Commission considered it had reasonable assurance that around three quarters (74 %) of all ERDF/CF and ESF OPs were free of a material level of error, and as a result no reservations were issued for these OPs, which accounted for 69 % of the total budget in the Cohesion policy area. However, the Court identified a number of risks which indicate that the Commission’s assessment may not be sufficiently robust in all cases.

— Firstly, the Court’s audits over the last 3 years have shown that some audit authorities under-report problems and that the reported error rates are not always fully reliable;
— secondly, audit authorities are not required to submit detailed information about their audits of operations to the Commission. This reduces the Commission’s scope for validating the annual error rates reported by audit authorities;

— thirdly, the Commission refers to residual error rate as one of the criteria for deciding whether or not to issue reservations for an OP. This rate is calculated by deducting from the audit authorities’ annual error rates (as applied to the payments made since the start of the programming period) the multiannual financial corrections imposed at national and EU level. The Court observes, however, that information on financial corrections reported by Member States may not always be reliable or accurate and that the Commission’s calculation method results in an understated residual error rate.

As a consequence, the Commission may underestimate the problems in its reporting to the European Parliament and the Council and incorrectly assess what is needed to achieve an unqualified audit opinion.

**RECOMMENDATION 1**

The Commission should ensure that its calculation of residual error rate does not understating the extent to which expenditure remains affected by error. In particular, the Commission should strengthen its verifications of the accuracy and reliability of the error rates reported by audit authorities and the information on financial corrections reported by Member States before using these elements in its own assurance process.

**RECOMMENDATION 2**

For the 2014–20 programming period, the Commission should introduce a system of net financial corrections for OPs in respect of which the audit authorities repeatedly under-report problems. This system should be based on the applicable provisions in the regulations.
84. The Court found that there was limited take-up of the options provided under Article 73, and delays in granting ‘single audit’ status to OPs. By the end of 2012, 61 of the 434 Operational Programmes in 12 of the 27 Member States had been granted Article 73 status. These OPs account for 15% of the total Cohesion budget. The Commission was not in a position to grant ‘single audit’ status to a first set of OPs until the sixth year of the 2007–13 programming period. This situation (which is similar to that relating to contracts of confidence in the previous programming period) illustrates the difficulties encountered by the Commission in effectively applying Article 73 as specified in the regulations.

85. The Court considers that 46 of the 61 Article 73 OPs complied with the minimum requirements for ‘single audit’ status. Cases of non-compliance relate mostly to ERDF OPs, where a higher share of OPs have been granted Article 73 status.

86. The Court also concludes that the Commission’s approach to monitoring Article 73 OPs (and the corresponding audit authorities) needs to be further developed and clarified. This is of particular importance in view of the role of audit authorities in the closure of OPs scheduled for 2017.

RECOMMENDATION 3

The Commission should in all cases apply robust, consistent and transparent criteria when granting ‘single audit’ status to Operational Programmes. In particular, the following minimum requirements should be fulfilled whenever Article 73 status is granted to an OP:

— the audit strategy and compliance assessment must have been accepted by the Commission;

— the OP’s internal controls must function effectively (and in particular the multiannual residual error rate must be below the Commission’s materiality threshold of 2%);

— the Court’s audits should not have identified significant weaknesses in the OP’s internal controls; and

— the audit authority must have been rated ‘effective’. 
The Court considers that the Commission has made significant progress since the start of the programming period on providing guidance material which contributes to better consistency in audit authorities’ approaches and methodologies. In particular, in April 2013, revised guidance on statistical sampling and the calculation of error rates was issued. This is an essential element of the Commission’s ‘single audit’ model which builds on national audit opinions based on checks of a representative sample of operations. The Court notes that the Commission’s legislative proposals for the 2014–20 programming period provide for the possibility of secondary legislation on these matters.

### Recommendation 4

The Commission should comply in its monitoring of Article 73 OPs (and the corresponding audit authorities) with the ISA requirements on using the work of other auditors. In particular, the Commission should continue to carry out a minimum level of checks and controls at the level of the national audit authorities so as to implement the ‘single audit’ model effectively.

### Recommendation 5

The Commission should take appropriate measures so that audit authorities can draw on a stable and binding methodological framework which ensures that EU spending in all Member States is checked according to the same standards and that the results are reported accurately. Further improvements are necessary as regards the disclosure of information in annual control reports, the scope and detail of the checks carried out for audits of operations and the follow up of audit findings (including financial corrections by Member State authorities).
WHAT ARE THE COSTS OF THE AUDIT ARRANGEMENTS INTRODUCED IN THE 2007–13 PROGRAMMING PERIOD?

88. Based on the information provided by audit authorities, the Court estimates the specific annual ‘cost of control’ for audit authorities at between 110 and 130 million euro. This amounts to 860 million euro, or 0,2 % of the total budget (in terms of EU and national public and private funding) of all ERDF, CF and ESF OPs for the 2007–13 programming period as a whole. This estimate is broadly in line with the Commission’s forecast in 2011.

89. The ‘cost of control’ is likely to increase further in the 2014–20 programming period, as audit authorities will have to carry out additional audit and control tasks. As pointed out in the Court’s Opinion No 2/2004, it is up to the European Parliament and the Council to consider whether such a significant level of costs is appropriate in view of the results obtained and how these costs are to be shared between Member States and the EU.

RECOMMENDATION 6

The Commission should propose arrangements for Member States and the Commission to share the cost of Cohesion controls, based on a more recent evaluation of the actual costs incurred by Member States.

This report was adopted by Chamber II, headed by Mr Henri GRETHEN, Member of the Court of Auditors, in Luxembourg at its meeting of 4 December 2013.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President
### ERDF/CF and ESF — Number of OPs and Total Budget (EU and National Public and Private Funding) for the 2007–13 Programming Period

<table>
<thead>
<tr>
<th>Fund (in euro)</th>
<th>Number of OPs</th>
<th>Funding</th>
<th>Total budget</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Community</td>
<td>National public</td>
</tr>
<tr>
<td>ERDF and CF</td>
<td>317</td>
<td>270 082 228 706</td>
<td>89 061 973 572</td>
</tr>
<tr>
<td>ESF</td>
<td>117</td>
<td>76 633 843 842</td>
<td>35 847 172 433</td>
</tr>
<tr>
<td>Total</td>
<td>434</td>
<td>346 716 072 548</td>
<td>124 909 146 005</td>
</tr>
</tbody>
</table>

Special Report No 16/2013 — Taking stock of ‘single audit’ and the Commission’s reliance on the work of national audit authorities in Cohesion
Responsibilities of Audit Authorities According to the Regulations

According to Regulation (EC) No 1083/2006, audit authorities are responsible for:

(a) assessing the management and control systems description proposed for each OP and providing an opinion as to its compliance with the regulations. The Commission has to approve this compliance assessment before it can authorise the first interim payment;

(b) developing an audit strategy within nine months of approval of an OP. The Commission has to approve the first audit strategy. The strategy must subsequently be updated each year or at the request of the Commission;

(c) undertaking ex post audits to verify the effective functioning of the management and control systems of OPs and audits of operations to verify expenditure declared (projects selected on the basis of an appropriate statistical sample to obtain a representative view of the legality and regularity of the expenditure declared for an OP (or group of OPs);

(d) presenting an annual control report (ACR) by the end of each year from 2008 to 2015, setting out the findings of audits carried out during the 12-month period ending on 30 June of the year concerned, together with an opinion as to whether the management and control systems function effectively;

(e) preparing a closure declaration (at the latest by 31 March 2017) assessing the validity of the application for payment of the final balance and the legality and regularity of the transactions underlying the final statement of expenditure, supported by a final control report.

Less stringent rules (‘proportional control arrangements’) apply in the case of OPs with total eligible public expenditure of less than 750 million euro and a level of Community co-financing not exceeding 40 %.

1 In particular Articles 59, 62 and 71.

2 Member States are, however, allowed to start making payments to beneficiaries through unapproved systems while awaiting the Commission’s approval of the compliance assessment.

3 Each AA may produce one or more ACRs and audit opinions on a single OP or a group of OPs.

<table>
<thead>
<tr>
<th>Validated projected error rate (2012)</th>
<th>≤ 2 %</th>
<th>&gt; 2 %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>181 OPs</td>
<td>3 OPs</td>
</tr>
<tr>
<td></td>
<td>160 without reservation</td>
<td>2 without reservation (both exceptions are disclosed)</td>
</tr>
<tr>
<td></td>
<td>4 partial reputational reservations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2 full reputational reservations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>10 partial reservations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 full reservations</td>
<td>1 full reservation</td>
</tr>
<tr>
<td></td>
<td>196 738</td>
<td>107</td>
</tr>
<tr>
<td></td>
<td>3 992</td>
<td></td>
</tr>
<tr>
<td></td>
<td>773</td>
<td></td>
</tr>
<tr>
<td></td>
<td>14 038</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4 999</td>
<td></td>
</tr>
<tr>
<td></td>
<td>220 541</td>
<td>3 112</td>
</tr>
<tr>
<td></td>
<td>77 OPs</td>
<td>27 OPs</td>
</tr>
<tr>
<td></td>
<td>65 without reservation</td>
<td>2 without reservation (both exceptions are disclosed)</td>
</tr>
<tr>
<td></td>
<td>3 partial reputational reservations</td>
<td>5 partial reputational reservations</td>
</tr>
<tr>
<td></td>
<td>7 partial reservations</td>
<td>1 full reputational reservations</td>
</tr>
<tr>
<td></td>
<td>2 full reservations</td>
<td>5 partial reservations</td>
</tr>
<tr>
<td></td>
<td>66 707</td>
<td>960</td>
</tr>
<tr>
<td></td>
<td>3 753</td>
<td></td>
</tr>
<tr>
<td></td>
<td>9 564</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4 769</td>
<td></td>
</tr>
<tr>
<td></td>
<td>84 792</td>
<td>35 930</td>
</tr>
<tr>
<td></td>
<td>5 OPs</td>
<td>24 OPs</td>
</tr>
<tr>
<td></td>
<td>2 without reservation both exceptions are disclosed</td>
<td>1 without reservations (disclosed exception)</td>
</tr>
<tr>
<td></td>
<td>3 600</td>
<td>1 partial reputational reservations</td>
</tr>
<tr>
<td></td>
<td>3 039</td>
<td>6 full reputational reservations</td>
</tr>
<tr>
<td></td>
<td>8 844</td>
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<td></td>
<td></td>
<td>13 full reservations</td>
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<td>2 692</td>
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<td></td>
<td>11 745</td>
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<tr>
<td></td>
<td></td>
<td>16 895</td>
</tr>
</tbody>
</table>

Note: Detail may not sum to totals because of rounding.
### Multiannual residual error rate (2007–13)

<table>
<thead>
<tr>
<th></th>
<th>≤ 2 %</th>
<th>&gt; 2 %</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Validated projected error rate (2012)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>≤ 2 %</td>
<td>65 OPs</td>
<td>1 OPs</td>
</tr>
<tr>
<td>60 without reservation</td>
<td>50 601</td>
<td>1 without reservation</td>
</tr>
<tr>
<td>5 partial reservations</td>
<td>21 857</td>
<td></td>
</tr>
<tr>
<td></td>
<td>72 458</td>
<td>826</td>
</tr>
<tr>
<td>≤ 5 %</td>
<td>28 OPs</td>
<td>3 OPs</td>
</tr>
<tr>
<td>24 without reservation</td>
<td>15 990</td>
<td>3 full reservations</td>
</tr>
<tr>
<td>1 full reputational reservation</td>
<td>1 368</td>
<td></td>
</tr>
<tr>
<td>2 partial reservations</td>
<td>9 505</td>
<td></td>
</tr>
<tr>
<td>1 full reservation</td>
<td>414</td>
<td></td>
</tr>
<tr>
<td></td>
<td>27 278</td>
<td>1 204</td>
</tr>
<tr>
<td>&gt; 5 %</td>
<td>13 OPs</td>
<td>7 OPs</td>
</tr>
<tr>
<td>5 without reservation (four exceptions not disclosed)</td>
<td>5 347</td>
<td>1 full reputational reservation</td>
</tr>
<tr>
<td>4 full reputational reservations</td>
<td>523</td>
<td></td>
</tr>
<tr>
<td>4 partial reservations</td>
<td>1 117</td>
<td></td>
</tr>
<tr>
<td></td>
<td>6 986</td>
<td>7 457</td>
</tr>
</tbody>
</table>

Note: Detail may not sum to totals because of rounding.
GENERAL PRINCIPLES STATED IN OPINION NO 2/2004 ON THE COMMISSION’S ‘SINGLE AUDIT’ MODEL (AND A PROPOSAL FOR A COMMUNITY INTERNAL CONTROL FRAMEWORK)

I. In order to ensure effective and efficient internal control of EU funds, a Community internal control framework should be developed containing common principles and standards, to be used as a basis for developing new or existing control systems at all levels of administration;

II. Controls should be applied to a common standard and coordinated to avoid unnecessary duplication;

III. Controls should be applied, documented and reported in an open and transparent way, allowing the results to be used and relied upon by all parts of the system,

IV. To allow controls to be effective and efficient, legislation underlying policy and processes should be clear and unambiguous and avoid unnecessary complexity;

V. Internal control systems should have, at their basis, a chain of control procedures, with each level having specific defined objectives which take into account the work of the others. Claims of expenditure or costs over a certain threshold should be accompanied by an independent audit certificate and report, based on common standards of approach and content;

VI. The Commission should define the minimum requirements for internal control systems whilst taking into account the specific characteristics of the different budgetary areas. Systems in each area should be accompanied by a coordinated information approach to ensure beneficiaries are clearly aware of the objectives and consequences of being checked;
VII. The internal control systems should include mechanisms to ensure that weaknesses in the systems themselves, as well as errors and irregularities in transactions, are identified and corrected and where necessary, recoveries made;

VIII. Internal control systems require an appropriate balance between the cost of controlling a particular budgetary area and the benefits the checks bring in terms of limiting the risk of loss and irregularity to an acceptable level;

IX. The Commission should be responsible for promoting the improvement in internal control systems in partnership with Member States. The Council and Parliament should be responsible for approving the cost/benefit balance for the different budgetary areas;

X. Clearly defined standards and objectives of internal control systems would provide an objective basis against which the Court could assess their design and operation when auditing them.
EXECUTIVE SUMMARY

II.
The Commission shares the Court’s conclusion and also considers that a better system for auditing Cohesion spending for the 2007–13 programming period is in place. The improved regulatory framework has put in place an audit authority in charge of testing legality and regularity of expenditure through system audits and audits of representative samples of operations and of reporting its conclusions each year to the Commission through an audit opinion and a control report.

III.
The Commission underlines that through the regulatory framework for 2007–13, the level of assurance it can obtain has increased significantly, in particular by allowing assessing the assurance for each operational programme each year as from the start of implementation. Therefore the cost of controls should be assessed from a cost-efficiency perspective.

The Commission notes that eligible costs under technical assistance at the disposal of Member States (Article 46 of Regulation 1083/2006) include audits and controls together with management, monitoring and evaluation costs. Available technical assistance monies are in most cases up to 4 % of funding for each programme.

IV.
The Commission welcomes the acknowledgement of its work and significant efforts, in close cooperation with audit authorities, to ensure better consistency in their approaches and working methods through guidance, targeted training and re-performance work that contribute to capacity building.
V.
The Commission’s assurance is based on the assessment of key elements of the management and control systems based on all available audit results.

The Commission has in place a robust and thorough process to analyse the error rates reported by Member States. When it cannot validate or recalculate error rates, the Commission estimates the level of risk by using flat rate amounts (5-10-25-100 %) instead of unreliable reported error rates for its assurance process. The use of additional tools, such as the cumulative residual risk, allowed Commission services to consider additional reservations in the annual activity reports compared to previous years.

The Commission always aims at ensuring that the reporting made to the Discharge Authority gives a fair and reliable picture of the estimated risk affecting the EU budget for each Member State, taking also account of the multiannual corrective capacity. The Commission services provide all available information in full transparency in their annual activity reports.

VI.
The Commission can only notify article 73 to a programme once a positive assessment of all elements of the management and control system is reached. This assessment of the audit authority’s work necessitates that sufficient on-the-spot re-performance audit work is carried out in accordance with international audit standards. The Commission considers it follows a prudent and robust approach to grant the ‘single audit’ status to some programmes so far.

VII. First indent
The Commission has a thorough verification process in place, including on-the-spot fact-finding missions, in order to ensure the accuracy and reliability of the error rates reported by national audit authorities. It alternatively uses flat rates when it considers error rates as unreliable. This process is complemented by an exhaustive Commission audit enquiry since 2009 whereby 269 audit missions allowed reviewing the work of audit authorities, including through re-performance, covering more than 90 % of Funds allocations. The Commission also carries risk-oriented audits to verify the accuracy of reported financial corrections.

VII. Second indent
The Commission considers that the single audit status was granted based on robust, consistent and transparent criteria. It furthermore considers that by the end of 2013 all requirements are fulfilled for these programmes.

The Commission will continue to apply a robust approach, further clarified with the implementation of its roadmap on Article 73, updated in September 2013.

VII. Third indent
The Commission considers this recommendation is implemented through the updated roadmap and the audit enquiry on monitoring Article 73 adopted in September 2013.

Following the granting of the first batch of Article 73 decisions in the first half of 2012 and based on pilot missions, the Commission services developed an audit methodology to carry out monitoring missions, which include re-performance work and working paper reviews, in line with International Standards on Auditing.

VII. Fourth indent
The Commission has introduced in its proposal for Common Provisions Regulation for 2014–20 and the legislator has agreed on the possibility for net financial corrections in the event of serious irregularities identified after the submission of the annual accounts and not previously detected and/or reported by the audit authority.

The Commission intends to propose in the secondary legislation that flat rate corrections can be increased for repeated breaches involving the same deficiencies, where the Member State has failed to take adequate corrective measures for that part of the system that was affected and subject to a previous correction.
VII. Fifth indent
The Commission is taking measures to ensure improved secondary legislation and timely and complete guidance within a stable methodological framework for the work of the audit authorities, building on the accumulated experience of the 2007–13 programming period.

The Commission will further clarify some aspects of the existing guidance through written clarification by the end of 2013.

Furthermore, according to the regulation for the 2014–20 programming period, the Commission is empowered to adopt, by means of implementing and delegated acts, binding models and/or requirements for the audit work of audit authorities that should build up on the experience and good practices of the 2007–13 programming period.

VII. Sixth indent
The Commission considers that this recommendation is already implemented in the 2011 Impact Assessment (see footnote 57). It further notes, under shared management and in respect of the principle of subsidiarity, the decision to allocate technical assistance to the different cost categories is taken by the Member States.

Furthermore, in the 2014–20 regulation, the Commission reinforces its cost-efficiency approach for Cohesion. As a consequence, the newly designed arrangements for the implementation of the funds, including in relation to controls, ‘(…) shall respect the principle of proportionality having regard to the level of support allocated and shall take into account the overall aim of reducing administrative burden for bodies involved in the management and control of the programmes’.

INTRODUCTION

7. In 2012 DG Regional and Urban Policy and DG Employment, Social Affairs and inclusion (hereafter ‘DG Employment’) received respectively 680 and 522 system audit reports from the audit authorities. The Commission analyses the results of all audit reports and uses them in its supervisory role during the year initiating interruption/pre-suspension procedures when needed and in its assurance process.

9. In order to be able to rely on the audit results and error rates reported by the audit authorities, and in line with international auditing standards, DG Regional and Urban Policy and DG Employment have so far carried out an extensive review and re-performance of the audit authorities’ work, which is and continues to be the main enquiry for DG Regional and Urban Policy and DG Employment.

When deficiencies are identified in the work of audit authorities, depending on the seriousness of the required improvements extensive action plans are put in place accompanied by interruption/suspension procedures where necessary to correct these deficiencies and bring the audit work up to standard. This re-performance of the audit authorities’ work also allowed an extensive capacity building by sharing audit checklists, raising awareness on risky areas and identifying areas and solutions for improvement of the national audit work.

The methodology for the assurance process and for determining reservations is described in annex 4 of the annual activity reports of DG Regional and Urban Policy and DG Employment.
REPLY OF THE COMMISSION

Box 2
The analysis of the error rates reported by year end by the audit authorities needs to be done for all 434 ERDF/CF and ESF programmes in good time for the annual activity report, a first version of which has to be ready by end February (and adjusted until the date of signature on 31 March). The Commission underlines that the objective is to indicate estimates of error rates within a statistically valid range, or in case of non-statistical sample foreseen in the regulation useful indicators to estimate the risk for the payments to the programmes in the year under assessment.

The Commission also uses flat rates to estimate that risk when it considers reported error rates to be unreliable.

The Commission refers in the annual activity reports to the average risk rate for all programmes of each Member State, based on the validated error rates, to quantify the amounts included in interim payments made in the year under assessment and at risk. Due to the decalage foreseen in the regulation to allow time for the audit authorities to carry out their audits, this estimate of the risk in payments made in year N is based on the validated error rate reported for expenditure declared in year N-1, being the best estimate available at the time of signing the annual activity report.

Since 2012 DG Regional and Urban Policy and DG Employment also present in their annual activity report the average cumulative (multi annual) residual risk per Member State, taking into account all corrections reported by the Member States as deducted from all payments claims up to the end of year N.

10. According to the Commission’s assurance process methodology, a programme with a validated error rate above 5% would be put under reservation already at step 1, unless the necessary financial correction and action plan have been implemented before the signature of the annual activity report (see also paragraph 40).

11. The Commission agrees that the processes to establish an overall error rate by the Court and the Commission’s assessment of the risk to its payments in the year differ for the reasons quoted by the Court and due to the nature of the different institutional roles. However the objective of this process is essentially the same, i.e. assessment of the risk to the EU budget in a particular year.

The Commission takes into account all these differences in its assessment, in particular timing differences in quantification of public procurement errors. This is evidenced by the fact that, as shown in the last three years in a row for DG Employment and two years in a row for DG Regional and Urban Policy, the result of this assessment is in line with the error rates calculated by the Court.

The Commission’s assessment also takes account of the multiannual character of cohesion policy and of the corrective capacity for each programme, through the calculation of a cumulative residual risk.

Some of the differences quoted by the Court will be removed in the regulatory framework for the 2014–20 programming period further enabling the full implementation of the single audit principle.

13. The Commission welcomed the principles laid down in the Court’s Opinion 2/2004, which have been an important element in developing the 2007–13 regulations concerning the set-up of the management and control systems.

15. The Commission welcomes the conclusion of the Court. The Commission has designed its system generally in line with the ‘Single Audit’ principles set out by the Court (see also paragraph 80).

The main advantage of applying article 73 for the Commission lies in the possibility to focus its limited audit resources to higher risk programmes and authorities rather than reduce its control work overall. In addition, single auditing still requires monitoring of the work of the audit authority and thus remains a crucial issue.

16. The conditions to grant article 73 relate both to the reliability of the work of the audit authority and to the fact that the management and control systems function well. The Commission must therefore carry out considerable detailed audit work in accordance with international standards on auditing, before it can grant an Article 73 status. This also explains why the Article 73 status can only be granted after some years of programme implementation.
REPLY OF THE COMMISSION

It also means that where the management and control system of a programme, independently from the audit authority, is still not sufficiently robust, no Article 73 status can be granted to the programme even if the Commission is satisfied based on its audit work with the functioning of the audit authority.

Common reply to paragraphs 17, 18 and 19
Each decision to grant an Article 73 is specific for a programme under the responsibility of the respective directorate general of the Commission.

The conditions to grant the article 73 status to a programme have been set out in a ‘roadmap towards the implementation of Article 73’ discussed with the Audit Authorities in 2009 and 2010 and finalised on 13 October 2010. The audit authorities have thus been fully associated and informed on the criteria and benefits of having an article 73 status for a particular programme.

The initial roadmap has been formally updated in September 2013, following the first decisions on granting Article 73 status in early 2012. The update relates to the clarification of the conditions to grant Article 73 as well as to the corrective measures to be taken if one or more of the conditions are (temporarily) no longer fulfilled. In addition a specific audit enquiry setting the methodology and steps to monitor the implementation of Article 73 has been jointly designed and is being implemented by all concerned Commission services under their inter-service level agreement.

As set out in the updated roadmap and in this audit enquiry, the Commission will take the decision to resume its own on-the-spot audits when it is no longer justified maintaining reliance on the work of the audit authorities. This may result from the fact that material deficiencies have not been reported and taken into account in the annual audit opinion for a given year and a request by the Commission to implement action plans/corrective measures has not been adequately followed up by the audit authority.

OBSERVATIONS

27. As indicated in the executive summary of DG Regional and Urban Policy’s 2012 annual activity report, the decrease in the number of reservations is mainly due to the corrective actions taken in the Member States and the implementation of financial corrections by the Commission (see 2012 annual activity report for DG Regional and Urban Policy, pages 46 to 49). The strict policy followed by DG Regional and Urban Policy on warnings, interruptions, suspensions and financial corrections has worked as an incentive for the concerned Member States to improve the weak management and control systems.

29. In addition to the two indicators mentioned by the Court, the Commission bases its assurance on an in-depth process and various steps, taking into account many other national and Union audit results and information beyond simply the two indicators quoted by the Court.

The result of this process and analysis is described in detail in the respective annual activity reports of DG Regional and Urban Policy 2012 and DG Employment (see page 35 and annex 9 and page 37 and annex 8 of respectively DG Regional and Urban Policy and DG Employment 2012 annual activity reports).
Common reply for paragraph 30 and box 4
The Commission acknowledges the fundamental role played by the audit authorities and the importance to ensure the accuracy and reliability of the information reported in the Annual Control Reports.

For this reason, the Commission carried out an extensive audit work done through 269 audit missions over the years in order to assess the effectiveness of the audit authorities covering 96% and 99% of the respective allocations of ERDF/CF and ESF.

Between 2009–13, the Commission re-performance audit work on audit authorities showed that:

— Out of 47 audit authorities audited, DG Regional and Urban Policy concluded that, at this stage, 38 audit authorities were reliable.
— Out of 84 audit authorities, DG Employment concluded that 78 were reliable.

The Commission thus considers that it has obtained reasonable assurance that audit authorities covering around 90% of the funds allocations comply with Article 62 of (EC) Regulation and this provides a reliable basis for the Commission’s assurance and for applying the single audit concept.

Those results are complemented by the Court’s examinations of audit authorities over the last three years.

In particular, when the Commission has doubts as to the accuracy and reliability of the error rates reported by national audit authorities, it discloses in its annual activity report the reported error rates which are recalculated when sufficient information is available, or which are replaced by flat rates when they are considered unreliable.

Box 4 — First indent
In two cases, the Commission notes that there were some weaknesses in the sampling approach, but considers that there was no significant impact.

In three cases, the Commission had found similar weaknesses as the ones reported by the Court and has taken appropriate actions. In one case reported by the Court in 2013, the follow-up is ongoing.

Box 4 — Second indent
In six cases, the Commission considers that the audit authorities are effective with respect to audits on operations. For the remaining six cases, the Commission followed up the weaknesses detected by the Court.

Box 4 — Third indent
In two cases, the Commission agrees that there were some weaknesses in the audit authority procedures and the Commission ensured the follow-up. However the Commission’s assessment of the reported error rates and annual control reports led to appropriate conclusions, considering also the additional audit work performed by the audit authority at the request of the Commission where necessary.

In the remaining three cases, the Commission had found similar weaknesses as the ones reported by the Court and took appropriate actions, including the interruption of payments until remedial actions were implemented by the concerned audit authority.

As a result of the actions taken to remedy weaknesses identified, the Commission has as of today reasonable assurance that all but one ERDF/CF and ESF audit authorities examined by the Court are effective. For the remaining audit authority identified by the Commission and the Court as non effective, remedial actions are still ongoing for some ERDF/CF and ESF programmes.
For the five audit authorities which under-reported error rates for ERDF/CF programmes during either 2010, 2011 or 2012, the situation is as follows:

— in one case, the under-reporting had no impact on the Commission's assessment because the audit authority's opinion was qualified and a reservation has been made in the 2010 annual activity report

— the cumulative residual risk was below 2% in another case,

— the Commission considered the reported error rates as unreliable and used flat rates for the purpose of its assurance process in three cases; it expressed reservations in the respective annual activity reports and interrupted payments to the corresponding programmes.

Moreover the Commission is working proactively with these audit authorities in order to improve the reliability of their reported error rates.

31. The Commission interrupts payments as soon as it has evidence to suggest problems including in the functioning of an audit authority. Furthermore, substantiated evidence of shortcomings in the functioning of an audit authority following a Commission audit always leads to the initiation of a suspension procedure until such time that the necessary corrective measures have been implemented by the Member State.

The corrective measures are further strengthened in the draft regulations for the 2014–20 programming period, which foresee net financial corrections in the event of serious irregularities identified after the submission of the annual accounts and not previously detected/reported by the programme audit authority.

Common reply to paragraphs 32 and 33

The Commission has developed a robust methodology to verify and validate the error rates reported by the audit authorities. The Commission's conclusions of the desk review with regard to the accuracy and reliability of the error rates reported in the annual control reports are also based on the assurance obtained from the extensive audit enquiry on the review of the work of audit authorities (see replies to paragraph 9).

Through this desk review process, the Commission clarifies any doubt that may arise as to the accuracy and/or reliability of the reported error rates. If needed, it obtains detailed audit results supporting the calculation of the error rate in writing or during on-the-spot fact-finding missions.

In 2013 the Commission services carried out 12 on-the-spot fact-finding missions covering 64 ERDF/CF programmes in 11 Member States and 15 missions covering 23 ESF programmes in 10 Member States. Based on all collected information, the Commission adjusted the reported error rates for 21% and 15% of the of the ERDF/CF and ESF programmes respectively, and considered 11% of the reported error rates for all programmes as unreliable and therefore replaced them by flat rates.

Furthermore, for the two ESF OP’s out of the 51 the Commission wishes to underline that the Court, in paragraph 6.34 of the Court’s 2012 Annual Report states that the shortcomings in the error rates reported by the Audit Authorities ‘do not put into question the number and impact of the reservations formulated by DG Employment in 2012’. For another 44 ERDF/CF programmes the Commission notes that the slight discrepancies reported by the Court did not put into question the number and impact of the reservations formulated by DG Regional and Urban Policy in 2012.

See also replies to paragraphs 34 and 35.
34. First indent
The Commission notes that the 51 programmes quoted by the Court correspond to the work of nine audit authorities out of the total of 112 audit authorities in charge of ERDF, ESF and Cohesion Fund. It notes that the technical issue raised in the case of 31 programmes grouped in a single sample does not modify the audit authority’s and the Commission’s assessments.

In the remaining cases, the Commission considers that sufficient information was available to conclude adequately on the error rates reported by the audit authorities.

See also Commission reply to paragraph 32.

34. Second indent
The Commission welcomes the fact that the Court has come to the same conclusions for all but five out of the 138 cases reviewed. Regarding these five cases that concern two audit authorities, the Commission confirms its assessment as reported in the 2012 annual activity report after an in-depth analysis of explanations provided by the concerned audit authorities and that there was no reason for a reservation. For four of these programmes regrouped in a single sample, the error was corrected in 2012 and therefore the Commission considers that it did not have to be included in the calculation of the projected error rate. For the fifth programme, the Commission considers that taking into account the part of the expenditure that was excluded from the population to be audited would have had a very limited impact on the error rate.

See also Commission’s reply to paragraphs 5.52, 4th indent, and 5.57 of the Court’s 2012 annual report.

The Commission therefore considers that it has correctly implemented its supervisory role on the error rates reported by the audit authorities.

35.
According to the method used for the 2010 annual activity report, the validated error rates were one of the elements for DG Regional and Urban Policy for its final assessment of the programmes. They were not used for the estimate of the minimum and maximum payments at risk, that was based on the methodology used in previous years. As explicitly indicated in its 2010 annual activity report (page 69), DG Regional and Urban Policy estimated the amount at risk between 0.8 % and 1.7 % of its 2010 payments and considered that ‘the reported error rates by the national audit authorities which relate to 2009 declared expenditure have to be interpreted with caution when assessing the functioning of the systems in 2010’ (page 31). All reported error rates were assessed and validated by DG Regional and Urban Policy, including upwards or using flat rate in more than half of the cases, in 2011 and subsequent years. In some cases reliable revised error rates have been communicated by audit authorities in 2011 or 2012.
Since 2011 onwards, DG Regional and Urban Policy revised its methodology allowing a more precise estimate of the amount at risk, based on error rates reported by audit authorities and validated by the Commission services. At the same time, DG Regional and Urban Policy introduced the calculation of a cumulative residual risk, taking into account financial corrections implemented by Member States. For this calculation, DG Regional and Urban Policy thus uses validated error rates for all years since the start of the programming period, including error rates subsequently revised by audit authorities, error rates it could recalculate and flat rates. Therefore the limitations expressed on the error rates at the time of their reporting in 2010 have no impact on the calculation by the Commission of the cumulative residual risk in 2012. The Court confirmed in its 2012 Annual report that DG Regional and Urban Policy’s estimate of amounts at risk for 2012 is in line with the assessment of the Court (paragraph 5.55 of the Court’s 2012 annual report).

Regarding the Directorate-General for Employment and Social affairs, the Commission refers to its reply to paragraph 34.

36. The Commission has actively promoted the use of statistical sampling in 2012/2013 through its updated sampling guidance of April 2013, even in the case of small populations of operations, so as to obtain representative results in an increasing number of programmes.

Moreover, it should be noted that the error rate can also be representative in case a formal approach to non-statistical sampling is used, or when the sample audited ensures a high coverage of the expenditure.

However, non-statistical samples for small populations of operations are in line with the regulation and provide the best available indication of the overall risk for the concerned programmes. In such cases, the Commission also takes into account the characteristics of the population and the audit coverage. The Commission has to use these indicators for the purpose of its assurance process and for the calculation of the cumulative residual risk.

In any case, where the Commission considers the reported error rate as unreliable, it uses flat rates.

37. The Commission agrees with the Court that accounting for financial corrections is a complex task given the timing differences between the Member States’ reporting and the Commission’s annual activity report deadlines and the various actors involved in their implementation. In order to reflect the multi-annual character of programmes implementation, including of financial corrections, the Commission calculates a cumulative residual risk that is an indicator of how the corrective capacity of the programme is progressing year after year. The Commission aims at ensuring a residual error rate below the materiality threshold at the end of the programming period, by taking into account all financial corrections incurred during the life of a programme.

38. The Commission has to work with the data provided by the Member States by end March each year under the regulatory requirements and which are available under the multi-annual set-up for cohesion policy.

38. First indent

The Commission needs to calculate the cumulative residual risk as at the end of the year under assessment in the annual activity report. The cumulative residual risk is an indicator of the corrective capacity of the programme over several years, taking into account the information available at the time of its calculation, both in terms of risk and of financial corrections made.

At the time of the annual activity report, the Commission has at its disposal the Member State’s reporting on financial corrections submitted the previous year and data reported for the current year for some programmes. This information can be reviewed by the Commission since most corrections are initiated at the request of the Commission itself.

Furthermore, the Commission has conducted specific risk-based audit work over the last 3 years covering 68 operational programmes in order to ensure that the corrections reported by the Member States are effectively implemented and, in case of doubts or insufficient evidence, deducts the amounts concerned from the cumulative financial corrections taken into account for the purposes of the calculation of the residual error rate.
38. Second indent
As indicated in the guidance on treatment of errors disclosed in the annual control report (COCOF_11-0041-01-EN of 7 December 2011), audit authorities have to project the error rate based on all audit findings and should not take into account financial corrections carried out as a result of their audits for calculating the projected error rates. When formulating their audit opinion, they can take into account subsequent events in the sense of financial corrections taken since the end of their audits. If these corrections are sufficient to mitigate the projected error rate, the audit authority may decide to report an unqualified opinion, but still has to report the projected error rate as calculated.

The Commission will remind the audit authorities about this rule.

38. Third indent
Pending recoveries are based on recovery orders issued by the Member State, and to be executed. They are requested by the regulation and it is legitimate to take these corrective actions into account.

38. Fourth indent
In accordance with the regulation, Member States have to report any withdrawal included in a payment claim of the previous year. As clarified in the guidance note, withdrawals are definitive and cannot be reinstated in subsequent payment claims, except if the irregular amounts were later found to be regular and eligible. In such cases the certifying authority should correct its reporting. The Commission will remind the certifying authorities about this rule.

39. Since the 2011 annual activity reports released in March 2012, any potential instances of negative residual error rates are adjusted to a minimum of 0 as part of the procedures put in place by the Commission to avoid underestimating the calculation of an overall cumulative residual risk.

The cumulative residual risk reflects the overall corrective capacity of a programme, taking into account the best estimate of the risk, the validated error rate, and information on all corrections carried out, independently from the source of the finding (managing, certifying or audit authority). Therefore, in extreme cases, a cumulative residual risk at zero shows that overall corrections reported and linked to expenditure previously included in payment claims to the Commission were higher than the estimated cumulative risk for the programme, at the time of the calculation.

40. Reservations are mainly based on the assessment of the functioning of the management and control system and the projected error rate. The cumulative residual risk is a second filter to decide on the need for additional reservations. In particular, but not exclusively, in case of a validated error rate between 2% and 5%, it allows deciding if additional reservations should be made. It is certainly not the main source of reservations in the annual activity report, but a complementary one.

This approach was followed for 65 ERDF/CF programmes out of the 67 quoted by the Court. For the remaining two programmes, as indicated by the Court in annex III to its report, exceptions in line with the annual activity report methodology were made and disclosed in the annual activity report since all necessary financial corrections had been implemented in time for the assurance process (cf. DG Regional and Urban Policy 2012 annual activity report, page 35).

For the 4 ESF OPs with the ‘projected error rates’ above 5%, the necessary financial corrections had already been implemented by the time DG EMPL 2012 Annual Activity Report was issued. Hence, the cumulative error rates calculated for those OP were below 2%. According to the Commission’s standing instruction for the 2012 Annual Activity Report, a (quantified reservation) is required only if the cumulative financial risk is above 2%. Moreover, for the four programmes concerned, the appropriate action plans were in place in order to prevent these issues from reoccurring.
Moreover, the Commission notes that in paragraph 6.34 of its 2012 Annual Report the Court states that the shortcomings identified in the error rates reported by the Audit Authorities ‘do not put into question the number and impact of the reservations formulated by DG EMPL in 2012’.

43. There are two processes which should be clearly differentiated: the formal reliance on the audit authority’s work under the conditions imposed by Article 73 of the regulation on the one hand, and the fact that the Commission may for the annual assurance process, following its in-depth assessment of the annual control report and taking into account its on-the-spot re-performance work, validate and therefore rely on the reported audit results on the other hand.

The figures reported by the Court reflect the prudent approach followed by the Commission, as mentioned in paragraph 47, and the double condition to rely not only on the audit authority’s work and reported error rates but also that all elements of the management and control system for the concerned programme are fully effective (see also reply to paragraph 16).

In addition, the fulfilment of the conditions does not trigger automatically a decision by the Commission to grant Article 73. The Commission uses professional judgement in order to weigh up all other relevant factors, including, among others, the materiality and criticality of each OP for the Fund as a whole.

**Common reply to paragraphs 44 to 46**

The Commission could only notify Article 73 once sufficient audit work had been carried out in accordance with international audit standards and a positive assessment of the audit authority could be reached.

In addition, even if decisions to grant Article 73 were taken in the sixth year of the 2007–13 period, the implementation of the programmes on the ground runs until 2015, and closure is up to 2017. Furthermore, the implementation of the single audit may play a role for the set-up of the management and control systems for the next programming period and the concept will be maintained and will have a positive impact up to 2023.

The 2010 roadmap was prudently indicating that ‘a first group of audit authorities could be in a position to benefit or may already benefit from the single audit principle for some programmes/systems and the Commission will principally rely on the opinion of the Audit Authority’. The Commission therefore could not preempt a precise time-line before having carried out its review. Indeed, the conditions foreseen in the regulation, as well as audit standards, require that the Commission obtains robust audit results after adversarial procedures before it can decide to implement article 73 to a specific programme. This was only possible after in-depth on-the-spot re-performance work by the Commission under its audit enquiry ‘Review of the work of audit authorities’, carried out as from 2009.

The Commission thus adopted a prudent approach since the first Article 73 status were only granted after having received the 2010 and 2011 annual control reports, which were the first ones to report error rates. In the same period, the Commission provided guidance on the elaboration of those reports, the treatment of errors, sampling, etc. in order to ensure reliability and consistency of the information received.

See also reply to paragraph 30.
47. The Commission aims at obtaining ‘reasonable assurance that the management and control systems function effectively’ through the assessment of detailed key requirements and functions for each programme. This assessment is based on a synthesis of all audit results by the Commission and the Member State and goes beyond the indication provided by the sole cumulative residual risk indicator. The Commission has formally updated its roadmap in September 2013, including by further clarifying the criteria it follows to grant Article 73: acceptance of the audit strategy and compliance assessment; reasonable assurance that the management and control system function effectively and bear limited risks; reasonable assurance that the audit authority works well and that only some or minor improvements are needed, taking account of the Commission’s cumulative audit knowledge and experience with this audit authority. It also considers the Court’s audit results.

48. Based on its own assessment, the Commission considers that the requirements are in place at the end of 2013 for all 61 programmes. In its assessment, the Commission bases itself on the results of the extensive audit enquiries started in 2009 to effectively verify the reliability of the Audit Authorities. It furthermore takes account of all regulatory provisions, including the use of non-statistical sampling in some cases as the best estimate of the risk and the effectiveness of the managing and control system, as well as the ‘cumulative residual risk’ calculated for each programme or groups of programmes since 2012 as indicated above.

Moreover, the Commission notes that the programmes referred to by the Court in Box 6 represent 5% and less than 1% of the respective global allocations for the ERDF/CF and the ESF.

Box 6 (a) — First indent
When programmes under a common management and control system are grouped for the purpose of the statistical sampling, as provided for in the regulation, the Commission cannot calculate a cumulative residual risk per programme since the audit authorities report one single error rate for all grouped programmes together. This approach is taken in all cases for all Member States when audit authorities group programmes under a single representative sample.

The six programmes quoted by the Court are part of eight programmes under a common management and control system. The reported and validated error rate for the group of programmes was 2.64% for 2011. The corresponding cumulative residual risk for the group of all eight programmes taken together, after corrections were made by the concerned certifying authority, was below 2%. The Commission therefore concluded that systems are effective for all eight programmes.

Box 6 (a) — Second indent
All conditions for the granting of Article 73 to this programme were already in place at the beginning of 2012. Nonetheless, the Commission decided to follow a prudent approach to address the risk of systemic errors in a specific measure of the programme. It therefore issued a partial reservation in the annual activity report to cover this risk. It was subsequently confirmed by the Member State that the entire expenditure related to this measure was preventedly withdrawn already in November 2011 and an action plan was implemented in 2012 to ensure that no expenditure was actually at risk for this measure. Following this conclusion, the partial reservation was lifted in November 2012. Following two on-the-spot audit missions, Article 73 was granted to the programme. The positive results reported in the annual control report for 2012 confirmed this assessment with a validated error rate below 2%, and the Commission issued an unqualified opinion in the annual activity report 2012.
Box 6 (b) — First indent

For the two ESF and one ERDF cases mentioned by the Court, the Commission confirms that the concerned audit authorities adequately followed the Commission’s guidance note on sampling, given the small size of the population. The Commission notes that the use of sample error rates based on non-statistical samples are foreseen in the regulation in the case of small populations of operations. These are the only available indicators to estimate the overall risk for the concerned programmes and are therefore used by the Commission for the purpose of the assurance process. In such cases, the Commission also takes into account the characteristics of the population and the audit coverage. In two ESF cases, given the small size of the population, the minimum coverage requirement (10 %) was met. For the remaining ERDF programme, the use in 2011 of a random selection covering high value items and more than 10 % of the expenditure was adequate.

Furthermore, the Commission based its assessment not only on the error rates reported in the annual control reports, but also on other elements gained through its audit work, such as re-performance of a number of the audit authority’s controls on operations and accumulated knowledge on the functioning of the systems concerned.

As those elements were positive, the Commission concluded that it had a sufficient basis to grant Article 73 for those three programmes.

For the 2013 sample, both audit authorities opted for a statistical sampling method considering the increase of the population’s size and the lower threshold triggering the use of statistical sampling set out in the revised sampling guidance provided by the Commission in April 2013.

See also reply to paragraph 36.

Box 6 (b) — Second indent

Article 73 was granted to these two programmes in June 2012 based on the conclusion that all conditions stipulated in the Commission roadmap had been fulfilled. At that moment the Commission had reviewed the sampling methodology used by the Audit Authority in four consecutive Annual Control Reports since 2008 and found it to be compliant. The information about the change of the sampling method was provided in December 2012 in the new Annual Control Report which was immediately assessed. Based on its assessment, the Commission noted that exclusion of expenditure from the population to be sampled was not in line with the rules. However, it concluded that this change of methodology had no impact on the reported error rates and had been chosen by the Audit Authority for reasons of cost-efficiency since the concerned beneficiaries had already been audited without generating errors in previous years.

The Commission notes that the change of methodology increased the audit coverage from 5 % to 20 % compared to previous years.

Box 6 (b) — Third indent

The OP referred to by the Court is the fourth smallest OP for ESF. Annual payments in 2010/2012 amounted to 1,5 million euro on average. Despite its very small size, Article 74 which sets out proportional control arrangements for small OPs could not be applied since the co-financing rate for this OP is above 40 %.

Furthermore, the Commission confirms that it had sufficient ground to grant Article 73 to this programme, which has a similar impact to Article 74 since, the ESF audit authority adequately followed the Commission’s guidance note on sampling, given the very small size of the population which was largely below the threshold required for statistical sampling quoted by the Court in footnote 9 (below 20 projects for 2011 and 2012). Therefore, statistical sampling could not be applied to the population concerned. However the minimum 10 % coverage required by the sampling guidance was achieved.

Furthermore, the management and control system for this operational programme was assessed as effective and the error rate reported by the managing authority and validated by the Commission was constantly below 2 %.
Box 6 (c)
The Commission considers that it granted Article 73 to these two programmes, based on robust, consistent and transparent criteria having taken account of the Court’s findings.

In one of the two cases referred to by the Court, the management and control system was assessed as effective and error rates reported by the audit authority and validated by the Commission have constantly been below 2% over the period (2010–12).

For the second case, the Court’s findings were not related to the functioning of the audit authority but to other parts of the management and control system and are being followed up. The Commission considers that deficiencies identified in the management and control system in 2013 do not necessarily impact its reliance on the work of the audit authority.

Box 6 (d)
Article 73 was granted to the two concerned audit authorities in June and September 2012. The Court’s observation refers to findings disclosed in 2013.

In any case, the Commission confirms, after a thorough assessment of the Court’s findings, that these audit authorities fulfil the requirements for Article 73. The Commission closely monitors that these requirements continue to be fulfilled under its recent joint audit enquiry on monitoring article 73 (see reply to paragraph 54).

Common reply to paragraphs 49 and 50
As stipulated in the updated roadmap and joint audit enquiry decided in September 2013, and reflected in the Commission services’ audit strategy, adequate monitoring of Article 73 is carried out through the analysis of national system audit reports and of annual control reports (including fact-finding missions where necessary), on-the-spot work paper review and re-performance of audits carried out by the audit authority and bilateral coordination meetings.

See also reply to paragraph 32.

Common reply to paragraphs 51 to 53
The roadmap was meant as a strategic document to set out the conditions for granting article 73 and for monitoring purposes and not as a methodological document. Following the first batch of Article 73 decisions in the first half of 2012, the methodology to carry out monitoring missions has been developed and the new enquiry has been fine tuned based on the experience of 2 pilot missions carried out in 2012, which included reperformance work and working paper review.

In accordance with the updated roadmap, the joint audit enquiry and the audit strategy, a monitoring mission will be carried out for every audit authority with Article 73 status in principle every 2nd year. These monitoring missions are including reperformance work and working paper reviews, in line with international auditing standards.

Common reply to paragraphs 54 and 55
DG Regional and Urban policy indicated in its 2012 annual activity report that based on its monitoring of the programmes with a single audit status conditions were still in place to justify this status, since the audit authorities had appropriately reported new deficiencies for some of the concerned programmes. Thus the concerned audit authorities continued to function appropriately.

In September 2013 the Commission has formally updated its initial roadmap and adopted an audit enquiry setting out the methodology and process for the monitoring of the ‘single audit’ status. Annex I of the updated roadmap contains an overview of actions/corrective measures in case one or more of the initial conditions to arrive at the implementation of the single audit principle are no longer complied with.

The Commission monitors all concerned programmes, including through re-performance work. At the end of 2013, the Commission’s monitoring covers 19 OPs with an Article 73, for seven audit authorities in line with the Commission's audit methodology. Specific corrective measures are being implemented for four audit authorities.
DG Employment did not identify any issues in its 2012 annual activity report warranting a reconsideration of the operational programmes that have been granted Article 73 in 2012. Therefore, no corrective actions had to be initiated in order to withdraw or suspend the single audit status granted in 2012. Furthermore, the Commission started monitoring missions on these OPs in late 2013.

56. The closure will build on the extensive audit and monitoring work performed during the period, in particular with respect to the annual assessment of the cumulative residual risk by programme. See also reply to paragraphs 49 to 53 on the updated roadmap and audit enquiry on monitoring.

The Commission also draws the attention to the fact that the implementation of the single audit concept will also continue in the period 2014–20 as stipulated in Article 140(3) of the common provisions regulation.

60. The Commission issued guidance over the first years of implementation which is essential for the audit authorities’ work (e.g. compliance assessment, audit strategy, assessment of management and control systems, sampling methods). These guidance documents were issued on time at the beginning of the programming period (see paragraph 62).

Common reply to paragraph 61 and Box 8
Guidance on complex issues, such as the ones quoted by the Court, is necessarily based on good and bad practices identified during the first years of implementation. Draft guidance is discussed during various technical meetings with the audit authorities before being finalised in the COCOF meeting. This was in particular the case for the guidance on the treatment of errors which was extensively discussed with audit authorities before being formally communicated.

66. First indent
The Commission agrees that this compulsory information could be further complemented through additional guidance as far as results of operations are concerned. The Commission intends to provide additional written clarification to audit authorities in this regard by the end of 2013.

66. Second indent
The Commission obtains additional information on the results of audits of operations, either on a writing form or during on-the-spot fact-finding missions, when required, based on its risk assessment (see reply to paragraph 32).

The Commission will consider the possibility to issue further written clarification on this issue.

66. Third indent
At closure, audit authorities are already required to do a multi annual assessment of the functioning of the management and control systems as well as of the corrective capacity at closure (see closure guidance issued in 2013).

66. Fourth indent
Concerning the impact of subsequent events on the audit opinion, this is already partly covered in the guidance on the treatment of errors issued in December 2011 as far as ‘positive’ events are concerned.

The Commission will consider the possibility to issue further written clarification on this issue.

The Commission has made proposals to cover all previous aspects in the implementing/delegated acts for the 2014–20 programming period to further harmonise implementation.

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2 ‘For operational programmes for which the Commission concludes that it can rely on the opinion of the audit authority, it may agree with the audit authority to limit the Commission’s own on-the-spot audits to audit the work of the audit authority unless there is evidence of deficiencies in the work of the audit authority for an accounting year for which the accounts have been accepted by the Commission’.
67. The regulation and as a consequence the guidance issued by the Commission take account of international audit standards but have to reflect the specificities and terminology used for cohesion policy.

Common reply to paragraphs 68–69
The extensive audit work to review the work of audit authorities since 2009 also entailed a comprehensive capacity-building exercise with the concerned audit authorities. This allowed in its turn an exchange of good practices with all audit authorities through additional guidance and technical meetings.

72. The Commission continues to provide training to audit authorities, in particular on sampling techniques, on the audit work in the view of closure of the 2007–13 period and on the audit for the new programming period.

73. The Commission notes that granting Article 73 to some programmes does not reduce its control work. The main advantage for the Commission lies in the possibility to focus its limited audit resources to higher risk programmes and authorities rather than reduce its control work overall. Moreover, single auditing does not mean no audit at all. Monitoring and follow-up missions remain necessary to ensure the continued reliability of the audit work of the national audit authorities.

Common reply to paragraph 74 to 76
The Commission underlines that through the regulatory framework for 2007–13, the level of assurance it can obtain has increased significantly, in particular by allowing assessing the assurance for each operational programme each year as from the start of implementation. Therefore the cost of controls should be assessed from a cost-efficiency perspective rather than in absolute terms.

77. Following years of high error rates in the period 2000–06 the Commission decided to propose reinforced management and control provisions, including statistical sampling, for the 2007–13 period. These proposals are largely reflected in the current legislative framework. The Commission notes that in the current programme period error rates are significantly lower.

78. The Commission anticipates that the costs of control for the 2014–20 programming period will remain stable.

With the different audit simplifications foreseen in the regulation, the reduction in administrative burden (for example reduced reporting requirements and extended use of simplified cost options) or the use of updated guidance on sampling may lead to considerable gains in audit effort.

This would more than compensate the additional efforts needed to audit the accounts and to review the management declaration.
Common reply to 79 and 80
The Commission welcomes the Court’s conclusion. The Commission also considers that the Member States and the Commission have reinforced the internal control framework for 2007–13 programmes compared to previous programming periods. The Commission considers that this contributes to ensuring a robust audit capacity across the Union.

83.
With regards to the risks identified by the Court, the Commission has the following position:

83. First indent
Since 2009 the Commission carried out extensive audits on the spot to review the work of audit authorities. It carried out 269 audit missions and reviewed 47 and 84 Audit Authorities for ERDF and ESF. This covers approximately 96 % and 99 % of the total allocations, respectively. These reviews allowed the Commission to give advice, to contribute to capacity building and to recalculate rates or replace them by flat rates if these were considered unreliable.

Overall, the Commission has a thorough process to verify the reliability of the error rates reported by the audit authorities which are revised where appropriate. The fact that the error rates reported in the annual activity reports of DG Employment and DG Regional and Urban Policy are in line with the error rate established by the Court corroborates the reliability of the auditing and reporting system.

83. Second indent
The Commission has also put in place a robust methodology to verify and validate the error rates reported by the Audit Authorities, including where necessary, additional requests of information and/or on-the-spot fact finding missions (in 2013, 64 ERDF/Cohesion Fund OPs in 11 Member States and 23 ESF OPs in 10 Member States).

The good knowledge gained on the functioning of a large number of audit authorities through its extensive audit enquiry proved to be very useful in the Commission’s assessment of the reported error rates.

83. Third indent
The Commission considers that the cumulative residual risk, which takes into account the error rates and financial corrections over the programming period, is an indicator of the overall corrective capacity of the programmes assessed each year by the Commission in its annual activity reports.

It is based on all available reported data for the previous years and the best estimate of the year under assessment.

It helps the Commission to tackle in particular but not exclusively the situation of programmes with validated annual error rates between 2 % and 5 %.

Such programmes, which were safe from reservations in the past, can now be subject to a reservation and subsequently to legal proceedings (interruptions/suspensions/financial corrections).

Thanks to the use of the cumulative residual risk, additional programmes are put into reservation, thereby mitigating the risk identified by the Court of an under-estimation of the risks for those programmes.

Furthermore, the Commission has conducted specific risk-based audit work in order to ensure that the corrections reported for 68 OPs over the last 3 years are effectively implemented and, in case of doubts or insufficient evidence, deducts the amounts concerned from the cumulative financial corrections taken into account for the purposes of the calculation of the residual error rate.
The Commission always aims at ensuring that the reporting made to the Discharge Authority gives a fair and reliable picture of the estimated risk affecting the EU budget for each Member State, taking also account of the multiannual corrective capacity. The Commission services provide all available information in full transparency in their annual activity reports.

The Commission thoroughly reviews each year the error rates reported by audit authorities. This verification process, together with the extensive results from its audit enquiries, allows the Commission to disclose full and reliable validated error rates in the annual activity reports and to make appropriate reservations when necessary.

To illustrate this, the Commission considers that the fact that for 3 years in a row for DG Employment and 2 years in a row for DG Regional and Urban Policy the Commission’s own estimated error rate as disclosed in the annual activity report is in line with the Court’s error rates confirms the validity and reliability of its approach.

**Recommendation 1**
The Commission considers that this recommendation is already implemented.

The Commission has a thorough verification process in place, including on-the-spot fact-finding missions, in order to ensure the accuracy and reliability of the error rates reported by audit authorities. It alternatively uses flat rates when it considers error rates as unreliable. This process is complemented by an exhaustive Commission audit enquiry since 2009 whereby 269 audit missions allowed reviewing the work of audit authorities, including through re-performance, covering around 90% of Funds allocations. The Commission also carries risk-oriented audits to verify the accuracy of reported financial corrections.

The Commission will continue to ensure a strict supervision of the reported error rates, to monitor and review the work of the audit authorities, and to make targeted audits on the quality of the certifying authorities’ processes to record and report financial corrections.

**Recommendation 2**
The Commission has introduced in its proposal for Common Provisions Regulation for 2014–20 and the legislator has agreed on the possibility for net financial corrections in the event of serious irregularities identified after the submission of the annual accounts and not previously detected and/or reported by the audit authority.

The Commission also intends to propose in the secondary legislation that flat-rate corrections can be increased for repeated breaches involving the same deficiencies, where the Member State has failed to take adequate corrective measures for that part of the system that was affected and subject to a previous correction.

84.
The figures described by the Court result from the strict conditions foreseen in the regulation which require comprehensive audit work by the Commission and the Member State, including re-performance work in accordance with international auditing standards, before being able to assess the functioning of the whole management and control system. In addition, the Commission had to wait that error rates be delivered in 2010 or even in 2011 in most cases due to the slow take off of implementation. The Commission had to carefully verify these rates as well as the results of its first on-the-spot re-performance of the work of the audit authorities to assess the effectiveness of the implementation of management and control systems.

85.
Based on its own assessment, the Commission strongly disagrees for all of the 15 cases mentioned in Box 6 and considers that the requirements are in place at the end of 2013 for all 61 programmes. In its assessment, the Commission bases itself on the results of the extensive audit enquiries started in 2009 to effectively verify the reliability of the Audit Authorities. It furthermore takes account of all regulatory provisions, including the use of non-statistical sampling in some cases as the best estimate of the risk and the effectiveness of the managing and control system, as well as the ‘cumulative residual risk’ calculated for each programme or groups of programmes since 2012 as indicated above. In addition, the objections raised are particularly unsuitable for small OPs.
Moreover, the Commission notes that the programmes referred to by the Court in Box 6 represent 5% and less than 1% of the respective global allocations for the ERDF/CF and the ESF.

86.
Since the audit of the Court, the concerned directorates-general of the Commission have jointly developed and adopted in September 2013 an audit enquiry to monitor the Article 73 decisions granted for the first time in 2012. In addition, they have taken a joint decision updating the roadmap to article 73 and the monitoring processes in September 2013.

See below reply to recommendation 4.

Recommendation 3
The Commission considers that the single audit status was granted based on robust, consistent and transparent criteria. It furthermore considers that by the end of 2013 all requirements are fulfilled for these programmes.

The Commission will continue to apply a robust approach, further clarified with the implementation of its roadmap on Article 73, updated in September 2013.

Recommendation 4
The Commission considers this recommendation is implemented through the updated roadmap and the audit enquiry on monitoring Article 73 adopted in September 2013.

Following the granting of the first batch of Article 73 decisions in the first half of 2012 and based on pilot missions, the Commission services developed an audit methodology to carry out monitoring missions which include re-performance work and working paper reviews, in line with International Standards on Auditing.

87.
The Commission welcomes the Court’s assessment and is continuing its close cooperation with audit authorities to constantly improve its guidance and support. The Commission is actively promoting the implementation of its revised guidance on sampling from April 2013 through training seminars in various decentralised Member States, to ensure adequate dissemination of the information to all concerned audit authorities in these Member States.

The Commission has started the dialogue with audit authorities to adequately prepare for the launching of the 2014–20 period, and to improve the secondary legislation on matters related to the work of the audit authorities.

Recommendation 5
The Commission agrees with this recommendation and is taking measures to ensure improved secondary legislation and timely and complete guidance within a stable methodological framework for the work of the audit authorities, building on the accumulated experience of the 2007–13 programming period.

The Commission will further clarify some aspects of the existing guidance through written clarification by the end of 2013.

Furthermore, according to the regulation for the 2014–20 programming period, the Commission is empowered to adopt, by means of implementing and delegated acts, binding models and/or requirements for the audit work of audit authorities that should build up on the experience and good practices of the 2007–13 programming period.

89.
Under the Treaty, Financial Regulation and sector specific regulations the division of responsibilities is clearly established. Within the context of the European Structural and Cohesion Funds a substantial technical assistance budget is available to Member States. They have to decide how to use this allocation.

See also Commission reply to recommendation 6.
Recommendation 6

The Commission considers that this recommendation is already implemented in the 2011 Impact Assessment (see footnote 57). It further notes, under shared management and in respect of the principle of subsidiarity, the decision to allocate technical assistance to the different cost categories is taken by the Member States.

Furthermore, in the 2014–20 regulation, the Commission reinforces its cost-efficiency approach for Cohesion. As a consequence, the newly designed arrangements for the implementation of the funds, including in relation to controls, ‘(...) shall respect the principle of proportionality having regard to the level of support allocated and shall take into account the overall aim of reducing administrative burden for bodies involved in the management and control of the programmes’.
European Court of Auditors

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