

<p style="text-align: center;">6th MEETING of the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds</p>
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Cross-cutting audit issues

1. Although there have been some improvement in quality and professionalisation of audit which contributed to significant decrease of error rates, important weaknesses still exist and the same objective could be achieved to even better degree and at lower cost for beneficiaries and institutions. Single audit principle constitutes a positive step forward, but the overall control and audit burden, which includes not just audit, but also management verifications and other checks required by regulations, remains too high.
2. Fostering trust among those who are controlled or audited and those who control or audit them, more focus on preventive actions, increasing clarity of rules and legal certainty, ensuring accountability and quality of audit work, proportionality and more reliance on national systems will not only help beneficiaries, who - being at the bottom of the audit/control pyramid - are ultimately bearing the biggest burden, but will also result in lower level of errors.
3. More fundamental review of all the checks beneficiaries are subject to is necessary for post-2020 period. Proportionality, more reliance on national effective systems, shift of focus from formal compliance to results, simplifying regulations and limiting guidelines are the key elements of this necessary reassessment.

A detailed action plan, including milestones and deadlines, to implement those measures related to recommendations which are still possible in the 2014-2020 period should be prepared by the Commission as soon as possible, presented to the High Level Group and implemented.

Report on Cross-cutting audit issues from the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds

Fostering trust among those who are controlled or audited and those who control or audit them, more focus on preventive actions, increasing clarity of rules and legal certainty, ensuring accountability and quality of audit work, proportionality and more reliance on national systems will not only help beneficiaries, who - being at the bottom of the audit/control pyramid - are ultimately bearing the biggest burden. But enhanced audit and control should also result both in lower error rates and better focus on results, improving performance of interventions.

Having acknowledged that between 2000-2006 programming period and 2007-2013 the improvement of the management and control system allowed the Cohesion policy error rate to decrease by 2/3, from around 16 % in 2006 to 5.2 % in 2015, the members of High Level Group (HLG) are strongly convinced that ensuring a balanced approach to audit and controls of ESI Funds is a prerequisite for success of any simplification effort.

On the basis of the report presented at the meeting of the HLG on 29 November, taking into account conclusions and ideas from a diverse group of stakeholders representing bodies responsible for audit of ERDF, ESF and EAFRD, as well as the Commission and Court of Auditors, and taking into account opinions of the REFIT platform which also consider audit and control as a key issue, the HLG formulated recommendations to mitigate the negative impact on beneficiaries of ESI Funds.

Conclusions

The current audit model of ESI Funds goes beyond what auditors are responsible for in similar national settings. The role of audit authority is to provide recommendations for managing authority. Under a well-functioning management and control system, the decision on the follow up of the recommendations, including on financial corrections, should be taken by the managing authority, and not imposed by the auditors. At the same time, discussion on how to improve effectiveness of the system in the future is difficult, because of the fear of financial implications. The negative impacts of this approach include in particular:

- diversion of resources from more substantive work (focus on results),
- selection of less risky (but also less innovative) projects,
- distrust among institutions in the system.

Institutions react to uncertainty and perceived risks by maximising safeguarding measures, trying to prevent their decisions from being challenged by other institutions in the system. The professional judgement of programme authorities is under constant challenge of being undermined. This preventive fear leads to inflexibility ("over-independence") and piling up of rules intended to protect credibility of the institutions from being undermined in the future. This fear of audits may lead to unnecessary gold plating and additional rules and, paradoxically become a source of additional errors.

The members of HLG recognise that the number of operations and beneficiaries subject to on the spot audits by the Commission auditors and the Court of Auditors is very limited and they appreciate increased reliance on the work of audit authorities (AAs) in the audit work of the Commission over the 2007-2013 and in view of the 2014-2020 period. However, because even the few findings have horizontal implications for many other operations in one or even more programmes, requiring additional management verifications and/or work by national audit authorities, they do contribute significantly to overall burden for beneficiaries. Even insufficiently justified initial audit findings which are later dropped can be disruptive for many months, undermining proper functioning of the systems and creating perception of uncertainty for beneficiaries.

The beneficiaries are at the bottom of the control and audit pyramid. They usually cannot distinguish between management checks by the managing authority (MA), possible further controls by the certifying authority (CA) and audits; hence the "single audit principle" if not combined with improvement in relation between work of MA/CA and AA would not be sufficient. The members of HLG recognise that in some Member States (MS) and programmes pragmatic solutions have been found which address the issue. Key elements of such best practices include good cooperation and communication channel between managing and audit authorities, high quality management verifications which can be relied upon by the AA in its work, and strong contradictory procedure, during which there is a real possibility to provide convincing audit evidence and information. However, the existence of problems in many other, very diverse programmes and MS proves the need for a systemic solution which goes beyond just relying on good informal cooperation and administrative practices.

The controls and audits stemming from EU rules work alongside parallel domestic control systems. Shared management programmes became the primary tool of verification and enforcement of other EU policies especially public procurement, while the focus should be first and foremost to the results achieved in terms the objective of each policy. The Cohesion policy and other ESIF should not be responsible for verification of everything just because mechanisms of other policies are not functioning or are not reliable. The fulfilment of ex ante conditionalities and designation following audit by independent audit body have not yet resulted in more trust in the systems which were judged well-designed. The HLG also take note of the increased need for professional and independent audit authorities in 2014-2020 which have to ensure programme authorities and Member States that no serious deficiency remains undetected and uncorrected before programme accounts are submitted to the Commission each year, since this could imply net financial corrections.

Recommendations to the Commission and Member State auditors for the 2014-20 period:

The members of the High Level Group agree that the negative impact of additional burden placed on beneficiaries could be addressed by the following actions strengthening the **preventive role** of audit:

- strengthening the **educational role of audit**, in particular by identifying good practices in Member States and sharing them with others, not just audit authorities but also management bodies and beneficiaries, and facilitating peer-to-peer activities;
- strengthening the **methodological role of audit**, by encouraging national and European auditors to be involved in the preparation of systems, and preventive audits focusing and identification of repetitive and redundant processes; there should also be more sharing, both at EU and national setting, of audit results, frequent weaknesses detected and sharing experience on measures applied to address them in different programmes and MSs, including through creation a database of anonymised EU findings for most common

mistakes accompanied also with measures of how effectively (in particular: minimising additional burden on beneficiaries and institutions) tackle them.

- strengthening **advisory function** of audit, especially by providing the authorities involved in management of programmes with timely recommendations on how to improve the system and how to change the procedures. Such approach could increase the flexibility of the institutions and decrease the over-independence mentioned above. Therefore the issue of deadlines is so important for an effective dealing with audit recommendations.

As regards **ensuring quality of audit findings** and **improvement of audit procedures**, the HLG recommends:

- improved **quality checks** ensuring that audit findings are not based on assumptions which are insufficiently grounded, nor are based on guidelines which are not binding for MS, nor are retroactive, as even if the findings are dropped later they create uncertainty and disruptions in the system which extends far beyond the operation being audited; there should be systemic follow-up and conclusions drawn upon the analysis of findings which later proved to be unjustified;
- in order to ensure effective non-retroactivity, audits should be carried out in accordance with the standard applicable at the time of signing of the contract with the managing authority and not at the date of the audit;
- accelerating the timeframe for audit conclusions (which currently sometimes lasts even several years) by ensuring that all actors in the process, including the Commission, respect clear **deadlines** set both within the audit procedures, and in the various interrupting and warning letters. Only in the case of outside factors (e.g. a police investigation which needs to be concluded before final findings could be formulated) there is a reason for undetermined periods;
- more effective **use of contradictory procedure** with involvement of auditors not responsible for initial findings, and empowerment to take actual decisions in response to arguments presented during the hearing;
- considering establishing where necessary at an appropriate level a body or arbitrator to which it would be possible to appeal before a hearing or legal proceedings. This entity could then analyse findings, reaction, reasoning, or an interlocutory option if new circumstances are discovered, etc. and could decide whether the findings are justified (as well as associated correction) or not;
- a regular exchange of experience and knowledge, not only among AAs, but **also with the individual MSs** and sharing the main conclusions from these discussions;
- improved communication to make it clear that an audit finding does not mean a confirmed irregularity and an **irregularity does not mean fraud**.

As the HLG already underlined in the previous reports, uncertainty in audit is the result of unclear rules which are then interpreted in reaction to individual findings. Significant improvement can be done only post-2020, but the HLG recommends the following actions concerning **interpretation and application of rules** to be considered already in the 2014-2020 period:

- introducing a **transition period** giving sufficient time for adjusting national procedures before new methodological guidelines are fully enforced;
- the Commission guidelines should not put into question the competence of the managing authorities to decide about financial corrections, without prejudice to the case law set by the Court of Justice;

- review and elimination of extra-legislative requirements imposed on some MSs e.g. by including them in programmes, which are not required from other MSs to **ensure equal treatment**;
- certain definitions, in particular **definition of innovation**, could already be harmonised across different policy fields.

The members of HLG consider that more needs to be done to increase **proportionality** and reduce duplication of audits with other control activities (i.e. management verifications), both within ESIF implementation systems and national setting. The measures should include:

- consistent application of the **single audit principle**, which should include the Court of Auditors, and avoiding overlapping controls, so the level above only controls the level below if they performed they work well; in this context, it would be desirable to raise the thresholds below which an operation is not subject to more than one audit;
- confirmation of fulfilment of ex ante conditionalities and good quality of management and control systems should have a tangible, practical effect on requirements, reducing pressure on beneficiaries;
- application of internationally accepted audit standards;
- reviewing and making **more proportional the thresholds for financial corrections** in the case of mistakes and errors which do not constitute fraud; the penalties should be either a smaller percentage (or degressive with the size of the support) of a fixed fine, which is significant enough but does not put delivery at risk; in this regard the Commission could be invited to review its decision on flat rate corrections for public procurement issues, and to ensure that only serious errors with evidenced impact on the services/works delivered bear financial corrections, and to further align the approach of the Commission and the Court of Auditors to avoid divergent messages to programme authorities and beneficiaries;
- the Commission should refrain from **overusing suspensions and interruptions**, unless there are no other options and there is no other way to prevent irreversible damage and distinguishing between fraud and unintentional errors; such actions create uncertainty for beneficiaries, and as punitive corrective measures should be used as a last resort; 10 % retention on interim payments for 2014-2020 should be taken into account to a larger extent, as it contributes to protecting the EU budget before all controls are performed in view of annual accounts;
- the **definition of irregularity** and the way it is applied needs to be reviewed; there must be a clear link to negative impact on EU budget (and not just speculative "could be" which is interpreted in a way which can cover almost any case) and it should be restricted to economic operators who are part of implementation system, without penalties for actions which are beyond public authorities control.

Recommendations to Member States and the Commission for the 2014-20 period:

As evidence from MSs which have simple systems with low error rates under current rules show, there is significant scope for actions which could be done by national authorities to improve the current situation. The members of the HLG recommend the following:

- there is a need for MSs where this is still a problem to continue improvement of their management systems and in particular quality of the management verifications; ECA considers that ca. 3 percentage points of DAS error rate could and should have been avoided by programme authorities if all information and available to MAs would have been appropriately analysed and assessed so there is a significant scope for improvement;

- the members of the HLG call on MSs to participate in collection of data necessary for the Commission to provide joint typology of errors and other information which could facilitate simplification; the MSs should also use and share their experience within the REGIO TAIEX PEER TO PEER tool;
- stronger dialogue between national AAs and MAs is needed. These should include more focus on preventive actions; agreeing common check lists for management verifications and audits of operations; involvement in validation of procedures, such as related to SCOs, and identification of redundant procedures in the audit process; mobility between AA auditors and MA, and between audit and implementation units at the Commission level could be useful to gain mutual respect and understanding of different and challenging tasks and perspective; strong and timely contradictory procedures which would not just rubber-stamp initial audit findings, but would provide effective means for beneficiaries and MAs to justify their position are also very important;
- MSs should fully explore potential for simplification already in the legislation, including simplified costs options, as simpler rules reduce error risk and eliminate uncertainty; full implementation of e-solutions would also significantly reduce burden on beneficiaries;
- All bodies should prepare clear audit schedules and make them available to all affected entities, and a clear outline with deadlines for each step should be available to better plan and allocate resources.

Preliminary suggestions for further reflection for post 2020:

The members of the HLG consider that a more fundamental review of the way audit is done under the shared management system should be conducted, strengthening subsidiarity and proportionality, exploring how and to what extent national systems could be used, and reducing the number and cost of control and audit activities for beneficiaries.

The key issues to be considered include:

- full harmonisation of terminology and concepts within ESI funds and across different EU policies; it includes different approaches to fixing co-financing rates in State aid and ESI Funds (aid intensities; rules for net revenue generating projects) and different approaches in defining beneficiary and size of projects in the context of State aid and in ESI Funds;
- shift towards risk-based auditing, reducing audit burden for beneficiaries with proven track record, but also for those who are public institutions and are therefore subject to national controls and audits;
- shift towards performance-based auditing where the result of the project is of key importance in the audit trail and the process/its implementation is of secondary importance
- examining limitations of current single audit rules and finding solutions which would ensure overall reduction of number of checks of beneficiaries by all authorities and bodies in the system;
- reducing audit burden by considerably simplifying regulations and limiting guidelines, introducing more simplified approaches and removing unnecessary requirements; incentives for reduction of the number of intermediary bodies should also be considered;
- performance-related payments;
- setting up communication, which will be based primarily on what was solved successfully and good experience, rather than on what the error rate is or how many programs have been suspended etc. This should be a joint task of the MSs, the Commission and the Court of Auditors, which has introduced the focus on the error rates

in the first place for the Union budget, while this is not the practice of national supreme audit institutions;

- streamlining designation procedure, so it is (in obligatory way) limited only to elements which changed significantly and examining in what way and to what extent the assurance gained in the designation process could result in full reliance on the national rules and national control and audit system;
- strengthening role of the Commission in providing advice and a helping role, intervening in crisis situations and stimulating / organizing / coordinating exchanges between MSs and within the MSs among different institutions;
- potential and criteria for differentiation with respect to audit and management verifications as well as the need for specific treatment of ETC programmes;
- feasibility of the model in which the Commission focuses on system audits while control of expenditure is solely the responsibility of the Member States, in line with principle of subsidiarity and shared management;
- involvement of Member States / national audit bodies with the Court of Auditors in the discharge procedure.