Identifying and preventing fraud & corruption in ESI Funds

Fraud Prevention & the Annual Assurance Process

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ERDF Audit Authority, Ireland

Brussels, 12-13 February 2019

This training has been organised by EIPA under the Framework Contract Nr 2018CE16BAT060. The opinions expressed are those of the contractor only and do not represent the EC’s official position.
Annual assurance process

Contents

- Annual Accounts
- Preparation by Certifying Authority
- Audit of Accounts by Audit Authority
- Acceptance by European Commission
- Audits of systems
- Audits of operations
- Irregularities and financial corrections
Main changes from 2007-2013

- Preparation of accounts

- New accounting year to align the assurance process

- A block of expenditure validated in the year;

- Payment applications cumulative over accounting year with a final application by 31 July; condition for introducing new interim payment applications for the subsequent accounting year;

- 1st interim payment application not before notification of designation (Art.135 CPR);

- Subsequent interim payments - unless annual implementation report not submitted.

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Reference year (Expenditure)

Audit work period
Finalise reports & prepare ACR

Examine/accept ACR’s

ACR
31 Dec N

AAR Assurance
April N+1

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Preparation of accounts (MS) (1)

Accounts submitted for each OP at the level of each priority axis including:

- Total eligible expenditure by beneficiaries to 30 June (in final payment claim by 31 July);
- Corresponding public expenditure incurred;
- Corresponding payments made to beneficiaries;
- Amounts withdrawn /recovered/ to be recovered, recoveries under Art.71 CPR and irrecoverable amounts;
- Pre-financing paid to FEI and advances under State aid schemes;
- Reconcile final payment claim for the accounting year, and, accounts.

Where CA excludes expenditure that is subject to an on-going assessment on legality and regularity, it may include it in a future payment application if found to be regular (Art.137 (2) CPR).

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Preparation of accounts (MS) (2)

Differences between accounts and final payment application for the accounting year may result from:

- Further management checks / corrections by MA;
- Further checks by CA and precautionary withdrawals to cross check the eligibility of expenditure (Art.137(2)CPR);
- Corrections linked to audits by the AA (system audits, audits on operations, audits on the draft accounts);
- Corrections linked to EU audits.

Any correction applied since the final payment application until the submission of the accounts (31 July - 15 Feb. N+1) – to be reconciled in the accounts.
Examination & acceptance of accounts
(Commission) (1)

Submission by 15 Feb N+1 of:

- Certified accounts (CA);
- Management declaration + Annual Summary of controls (MA);
- Annual Control Report with Audit Opinion on Accounts (AA)
  - true, fair, complete,
  - the proper functioning of systems
  - legality & regularity of expenditure,
  - consistency with the management declaration.
Examination & acceptance of accounts
(Commission) (2)

Examination and acceptance of account:

- an accounting process
- not covering legality and regularity of underlying transactions;
- EC assessment on the accounts and the related audit opinion.

Legality and regularity is assessed on the basis of remaining documents:

- Management Declaration,
- Annual Summary,
- Annual Control Report
- Audit Opinion.
Examination & acceptance of accounts (Commission) (3)

• Acceptance based on an unqualified audit opinion on the accounts

• Unless EC has evidence of the unreliability of the AA opinion (Art.139(2)CPR)

• By 31 May N+1 Commission informs MS whether or not accounts accepted.

• In case of acceptance (accounts are complete, accurate and true):
  • Calculation of amounts chargeable to the Fund for the accounting year
  • Balance to be paid in 30 days or deducted through recovery order offset in next interim payment (no net correction)
  • Without prejudice to possible subsequent financial correction decisions

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Examination & acceptance of accounts (Commission) (4)

In case of non-acceptance of the accounts:

- Commission determines the amount chargeable to the Fund & informs MS;
- If MS agrees within 2 months, accounts are accepted & balance is paid/recovered;
- If no agreement, Commission adopts a decision setting out the amount chargeable;
- This is not a financial correction decision reducing contribution from the Fund (balance is paid/recovered);
- Acceptance or Commission decision is without prejudice to the application of financial corrections by the Commission under Art.144-145 CPR.
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Internal Controls ... and Fraud

- Separation
- Organisation
- Authorisation & approval
- Physical
- Supervision
- Personnel
- Accounting
- Management
## Systems Audits Key Requirements

(EGESIF Commission Guidance Note)

<table>
<thead>
<tr>
<th></th>
<th>2007-2013</th>
<th>2014-2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managing Authority / IB</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Certifying Authority</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Audit Authority (DG Regio)</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15</strong></td>
<td><strong>18</strong></td>
</tr>
</tbody>
</table>
# Systems Audits KRs - Managing Authority

<table>
<thead>
<tr>
<th>AUTHORITY</th>
<th>KR NO.</th>
<th>KEY REQUIREMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>MA/IB</td>
<td>1</td>
<td><strong>Adequate separation of functions</strong> and adequate systems for reporting &amp; monitoring where the responsible authority entrusts execution of tasks to another body.</td>
</tr>
<tr>
<td>MA/IB</td>
<td>2</td>
<td><strong>Appropriate selection of operations.</strong></td>
</tr>
<tr>
<td>MA/IB</td>
<td>3</td>
<td><strong>Adequate information to beneficiaries.</strong></td>
</tr>
<tr>
<td>MA/IB</td>
<td>4</td>
<td><strong>Adequate management verifications.</strong></td>
</tr>
<tr>
<td>MA/IB</td>
<td>5</td>
<td>Effective system in place to ensure that all documents regarding expenditure and audits are held to ensure an <strong>adequate audit trail.</strong></td>
</tr>
<tr>
<td>MA/IB</td>
<td>6</td>
<td>Reliable system for collecting, recording and storing data for monitoring, evaluation, <strong>financial management</strong>, verification and audit purposes.</td>
</tr>
<tr>
<td>MA/IB</td>
<td>7</td>
<td>Effective implementation of <strong>anti-fraud measures</strong> (New)</td>
</tr>
<tr>
<td>MA/IB</td>
<td>8</td>
<td>Appropriate procedures for drawing up the <strong>management declaration</strong> and <strong>annual summary</strong> of the final audit reports and of controls carried out</td>
</tr>
</tbody>
</table>

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Fraud risk assessment & anti-fraud measures (new)

Managing Authorities must:

• put in place a minimum set of effective and proportionate anti-fraud measures
• carry out a fraud risk assessment

Audit authority must:

▪ verify that the MA's fraud risk assessment is credible
▪ provides a true and fair assessment of the risks and
▪ verify that adequate anti-fraud measures in place to mitigate risks
# Systems Audits KRs - Certifying Authority

<table>
<thead>
<tr>
<th>AUTHORITY</th>
<th>KR</th>
<th>KEY REQUIREMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA</td>
<td>1</td>
<td>Adequate separation of functions and adequate system for reporting and monitoring.</td>
</tr>
<tr>
<td>CA</td>
<td>2</td>
<td>Adequate procedures for drawing up and submitting payment application.</td>
</tr>
<tr>
<td>CA</td>
<td>3</td>
<td>Appropriate computerised records of expenditure declared and of the corresponding public contribution</td>
</tr>
<tr>
<td>CA</td>
<td>4</td>
<td>Appropriate and complete account of amounts recoverable, recovered and withdrawn</td>
</tr>
<tr>
<td>CA</td>
<td>5</td>
<td>Appropriate procedures for drawing up and certifying the completeness, accuracy and veracity of the accounts.</td>
</tr>
</tbody>
</table>
# Systems KRs - Audit Authority

<table>
<thead>
<tr>
<th>AUTHORITY</th>
<th>KR</th>
<th>KEY REQUIREMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>AA</td>
<td>1</td>
<td>Clear definition, allocation and separation of functions.</td>
</tr>
<tr>
<td>AA</td>
<td>2</td>
<td>Adequate procedures for systems audits</td>
</tr>
<tr>
<td>AA</td>
<td>3</td>
<td>Adequate procedures for audits of operations</td>
</tr>
<tr>
<td>AA</td>
<td>4</td>
<td>Adequate procedures for Annual Control Report (ACR) and Opinion</td>
</tr>
<tr>
<td>AA</td>
<td>5</td>
<td>Adequate procedures for providing a reliable audit opinion on the Annual Accounts.</td>
</tr>
</tbody>
</table>
## Systems Audits categories of opinion

<table>
<thead>
<tr>
<th>Category</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 1</td>
<td>Works well, only minor, <strong>or no</strong>, improvements needed</td>
</tr>
<tr>
<td>Category 2</td>
<td>Works, but some improvements are needed</td>
</tr>
<tr>
<td>Category 3</td>
<td>Works partially, substantial improvements are needed</td>
</tr>
<tr>
<td>Category 4</td>
<td>Essentially does not work</td>
</tr>
</tbody>
</table>
Audit Authority Sample selection
(Article 127(1) of CPR)

- AA must audit appropriate sample of operations from claimed expenditure
- Should be representative sample – generally based on statistical sampling
- Non-statistical sampling may be used:
  - on professional judgement of AA in duly justified cases
  - in accordance with internationally accepted audit standards, and,
  - where number of operations in accounting year too small for statistical sample
  - non-statistical sample shall be sufficient to enable a valid audit opinion
  - Non-statistical sample must cover;
  - min. 5% of operations for which expenditure declared in accounting year, and,
  - min. 10% of expenditure declared during accounting year.

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Operations audits
Sampling of operations

Sample interval - €0.5m

Projects “hit” (selected)
Projects “missed” (not sampled)

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Audits of operations
(Examples of records examined)
Audits of operations (1)
(Art. 127(7) CPR; Article 27 DA)

- Audits of operations for each accounting year (1 July N-1 to 30 June N),
- the first one ending on 30 June 2015.

Audits of operations shall

- be carried out on the basis of supporting documents constituting the audit trail and
- verify the legality and regularity of expenditure declared to the Commission;
Audits of operations (2)
(Art. 127(7) CPR; Article 27 (2.a,b) DA)

- meets the OP selection criteria;
- has not been physically completed / fully implemented before the beneficiary's application for funding;
- has been implemented in accordance with approval decision;
- fulfils any conditions applicable at the time of the audit concerning its functionality, use, and objectives to be attained;
- the expenditure declared to the EC corresponds to:
  - accounting records;
  - supporting documentation required to demonstrate an adequate audit trail;
Audits of operations (3)
(Art. 127(7) CPR; Article 27(2.c) DA)

- for expenditure declared based on **standard scales of unit costs or lump sums** [determined in accordance with Article 67(1)(b) and (c) [SCOs] and Article 109 [joint action plan] of CPR and Article 14(1) of ESF Regulation];

- outputs & results underpinning payments to the beneficiary have been delivered;

- participant data or other records related to outputs and results are consistent with the information submitted to the EC;

- the required supporting documentation demonstrates an adequate audit trail.
Audits of operations (4)
(Art. 127(7) CPR; Article 27 (2,3) DA)

- Audits shall also verify that the public contribution has been paid to the beneficiary < 90 days after Beneficiary claim (in accordance with Article 132(1) of CPR).

- Audits of operations shall, where applicable, include on-the-spot verification of the physical implementation of the operation.

- Audits of operations shall verify the accuracy and completeness of the corresponding expenditure recorded by the CA in its accounting system.

- The reconciliation of the audit trail at all levels.
Audits of operations (5)
(Art. 127(7) CPR; Article 27 (5, 6) DA)

- Where problems detected appear to be **systemic** - a risk for other operations in OP,

- the AA shall ensure
  - further examination, including, where necessary, additional audits
  - to establish the scale of such problems, and,
  - shall recommend the necessary corrective actions.

- Only expenditure examined in audits of operations = amount of expenditure audited, for the purposes of reporting annual coverage to the Commission.
Preparation of accounts (MS) (1)

Accounts submitted for each OP at the level of each priority axis including:

- Total eligible expenditure by beneficiaries to 30 June (in final payment claim by 31 July);
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Determination of serious deficiencies

- Determination of serious deficiency
- Interruption of the payment deadline
- Suspension of payments
- Financial corrections
  - by the Member States
  - by the Commission
- Net corrections
Determination of serious deficiency

“Serious deficiency in effective functioning of management and control systems”

Legal definition Article 2(39) CPR:

• "deficiency for which substantial improvements in the system are required, which exposes the Funds and the EMFF to a significant risk of irregularities, and the existence of which is incompatible with an unqualified audit opinion on the functioning of the management and control system".

• "Irregularity" and "systemic irregularity" also defined - Article 2 (36) and (38) CPR.

• Regulation (EU) No 480/2014: criteria for determining whether there are serious deficiencies.
Interruptions
Under Art.83 CPR

Payment deadline for interim payment claim may be interrupted for a max. of 6 months if:

a) Information from a national or EU audit body - clear evidence suggesting a significant deficiency in the functioning of the management and control system.

b) The Commission has to carry out additional verifications following information alerting that expenditure in a request for payment is linked to an irregularity having serious financial consequences.

c) There is a failure to submit one of the documents required under Article 59(5) of the Financial Regulation (i.e. accounts, management declaration, annual summary, audit opinion, ACR) (New)

Note: MS may agree to an extension of the interruption period for another 3 months (New)
Suspensions (1)
Under Article 142 CPR

The Commission may suspend all or part of the interim payments

- at the level of priorities or operational programmes

- if one or more of the following conditions are met:

  - Serious deficiency in the MCS of the OP and corrective measures not taken

  - Serious irregularity in the statement of expenditure which has not been corrected

  - MS fails to remedy the situation leading to interruption under Art.83 CPR

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New requirement for 2014-20:

- Serious deficiency in the quality and reliability of the monitoring system or of the data on common and specific indicators
- Failure to complete actions for ex-ante conditionality
- Performance review shows failure to achieve priority milestone (indicators)
- Measures linked to sound economic governance (Art.23(6)CPR), where a MS fails to take effective action on foot of request by Commission to review & amend the Partnership Agreement
Financial corrections

1. **Common Provisions Regulation (EC) No 1303/2013**
   - Art.143: Financial corrections by the Member State
   - Art.144-147: Financial corrections by the Commission

**Regulation (EU) No 480/2014**
- Criteria for financial corrections linked to the Performance Framework
- Criteria for determining whether there are serious deficiencies in the functioning of management and control systems
- Criteria for applying flat rates or extrapolated financial corrections and criteria for determining the level of financial correction

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Financial corrections – Member State
(A143 of CPR)

Member State (in first place):

• Responsible for investigating irregularities
• Making financial corrections
• Pursuing recoveries
• If systemic, extend investigation to all potential operations affected

• Apply a proportionate correction based on nature and gravity of irregularities
• Recorded by MA in accounts for financial year of cancellation
• Contribution cancelled may be not be re-used
  • for operation subject to correction
  • Operation affected by systemic irregularity

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Financial corrections – Commission
(A144 of CPR)

Commission (after carrying out examination) concludes:

- Serious deficiency in effective functioning of MCS of OP
- Has put at risk, **Union contribution already paid to OP**
- MS has failed to correct under A143 of CPR (*previous slide*)
- Expenditure in a payment application is irregular / not corrected by MS.
- Correction based on:
  - Individual cases and/or consideration of whether it is systemic
  - If not possible to quantify precisely – apply extrapolated or flat-rate corrections
- Respect proportionality (like MS) – based on nature and gravity of irregularities or financial implications of deficiency in MCS
- Failure to achieve targets in Performance Framework
- Cancel all/part of Structural Fund contribution to MS (net correction!)

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Types of financial corrections

**Types of correction:**

- **Specifically quantified corrections**
  Quantifiable error for individual or several operations – exact amount (ineligible invoice)

- **Extrapolated corrections**
  Error recurs in other operations of same type / measure / organisation etc.

- **Flat rate corrections**
  Individual breaches or systemic failures that are not quantifiable (procurement, publicity etc.)

In practice, it is preferable that MS applies corrections where detected.
Flat rate corrections - scales

**100%**

Serious deficiency(ies) in MCS so **fundamental, frequent or widespread**

= **Complete failure** of system

=> puts at risk, legality and regularity of **all expenditure concerned**.

**25%**

Serious deficiency(ies) in MCS so **frequent and widespread**

= **extremely serious failure** of system

=> puts at risk, legality and regularity of a **very high proportion of expenditure**.

**10%**

Serious deficiency(ies) in MCS, system **not fully functioning or functioning so poorly/infrequently**

=> puts at risk, legality and regularity of **high proportion of expenditure concerned**.

**5%**

Serious deficiency(ies) in MCS, system **not functioning consistently**

=> puts at risk **significant proportion of expenditure** concerned.

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QUESTIONS?

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