The control system for Cohesion Policy

How it works in the 2007–13 budget period
Contents

Foreword 3

1. Introduction: Cohesion Policy – Funds, activities and budgets in the 2007-13 budget period 5

2. The delivery and control system 6-7

3. The control system in operation 8-11

4. The control system over time – how assurance is built up 12-13

5. What happens when problems are found? 14-15
Foreword

The Cohesion Policy programmes co-funded by the EU budget help to transform regional and national economies through investment in infrastructure, business development, training, innovation and the environment; they deliver long-term sustainable growth and contribute significantly to job creation.

One of the key factors in the success of the policy is its decentralised delivery system. The programmes are managed at regional and local level so the projects selected respond to the priorities at those levels. But this is associated with a higher control risk because it increases the number of bodies involved and makes the control chain longer.

To ensure that European Union taxpayers’ money is used correctly, good training and guidance must be in place in order to ensure that all the actors properly understand the rules which apply, and there must be effective controls to detect and correct errors and deter attempted fraud.

We believe that with the benefit of a clearer and stronger legal framework for the 2007-13 programme period, the Commission and the Member States together can make the control system for Cohesion Policy work effectively to achieve the standards expected by the EU taxpayer and monitored by the European Parliament.
Allocation of EU funds for Cohesion Policy in 2007-13 by Member State, in € millions
Introduction: Cohesion Policy – Funds, activities and budgets in the 2007-13 budget period

Cohesion Policy financing is delivered through seven-year Operational Programmes from three funds:

- the European Regional Development Fund (ERDF), which finances infrastructure projects, environmental investment, urban renewal, local economic development including small and medium-sized enterprises, and cross-border and inter-regional cooperation;

- the European Social Fund (ESF), which finances training, especially for disadvantaged groups in society and the unemployed, and the development of education and training systems;

- the Cohesion Fund, a separate instrument with special rules for financing transport and environmental infrastructure.

€347.410 billion of European Union funding – or around €50 billion a year, a third of the EU budget – is available to Member States to reduce disparities in regional and social development over the 2007-13 Financial Perspective period.

The ERDF and ESF are the original ‘Structural Funds’ and are used throughout the European Union. The Cohesion Fund was established in 1992 and is limited to countries with a GNI of less than 90% of the average for the EU-25 Member States over the period 2001-03. The budget allocations for Cohesion Policy per Member State are related to population and national GDP.
The delivery and control system

Decentralised delivery demands a multi-level, integrated control system

Cohesion Policy spending is managed in partnership between the Commission and the 27 Member States, under a system called ‘shared management’. It is an essential element of the policy that it is decentralised, with the Member States and the regions taking the lead role in deciding how the money should be used and bearing the responsibility for managing it properly. Within the Member States, hundreds of organisations are involved in managing different parts of Operational Programmes, and hundreds of thousands of beneficiaries implement individual projects. The Commission has a supervisory role in ensuring that spending is in line with agreed strategic priorities and financial rules. It is accountable under the EC Treaty for the proper implementation of the budget. Two of its departments are mainly responsible for supervising Cohesion Policy spending, namely the Directorates General for Regional Policy and for Employment, Social Affairs and Equal Opportunities.

The objectives and priorities for the use of the funds are laid down in individual Operational Programmes at national or regional level negotiated between the Commission and each Member State and formally approved by the Commission. There are 316 Operational Programmes in the 2007-13 period. The programme authorities select the projects to attain the objectives set and to which the funds contribute. Throughout the period the Member State regularly declares the programme expenditure to the Commission and the Commission reimburses the agreed EU contribution. Beneficiaries have until the end of 2015 to complete projects and present the expenditure. The programme authorities then present the final expenditure claim and the programme is closed with a final payment to the Member State.

Rules and conditions require effective controls as well as prevention

Funding of projects under an Operational Programme is subject to certain rules and conditions, laid down partly at EU and partly at Member State level. These rules are established to ensure value for money, proper management of the programmes and consistency with Community policies.

The rules govern in particular:

- the location and type of the activities co-financed,
- criteria for selecting projects,
- assessment of cost-benefits and earnings potential of projects,
- the period during which expenditure can be incurred,
- the minimum proportion of spending that is required on projects serving EU priorities such as innovation, job creation and the environment,
- excluded or restricted activities or cost categories,
- retention of supporting documents over minimum periods for audit purposes,
- adequate publicity,
- competitive tendering, economic, social and environmental impact assessment, and compliance with rules on State aid, where applicable.
Are the rules too complex?

Most of the detailed rules on eligibility are fixed at national level, which means that Member States can make sure that they are clear and straightforward to apply and properly understood by beneficiaries.

The Commission has carried out a review of the legislation with national experts to identify possible ‘simplifications’. Some changes were made to the regulations in late 2008 and the first half of 2009, and further proposals will be adopted by the end of the year.

A certain degree of complexity is unavoidable, both because it is necessary to make sure that the €347 billion is used for the intended purposes, and because the rules of other Community policies such as State aid and public procurement must be applied.

Under shared management, the Member States have primary responsibility for control of programme expenditure, while the Commission performs a supervisory role over national systems. The different levels of control must be independent of one another in order to perform their functions properly. In the Member States there are three control levels, and the corresponding bodies in each programme are the Managing Authority, the Certifying Authority and the Audit Authority. The multi-level control system is integrated on the basis of clearly defined responsibilities for the various actors, established standards for the work required, and reporting systems and feedback mechanisms so that each level of control builds on the preceding one, with a view to reducing the burden, in particular, on beneficiaries. This integration is called the ‘Single Audit’ approach.

Preventive measures are part of the overall control strategy. Dissemination of information is an essential element of a good management and control system and helps to prevent problems occurring and to foster compliance.

Among their information activities, programme authorities are required to invest in guidance and training of beneficiaries and the bodies involved in implementing programmes. The Commission, too, provides guidance and training, but if it is to have an impact, this information needs to be passed on down the chain to the beneficiaries.
The control system in operation

3.1 The core control functions – Managing and Certifying Authorities

The Managing Authority is the first level of control and has the key responsibility for making sure that the programme is effectively and correctly implemented. It is required:

- to make sure that operations selected for the programme comply with the criteria;
- to advise beneficiaries on what they have to do to meet the terms and conditions of funding;
- to put in place and operate internal controls to check that expenditure presented by beneficiaries is regular;
- to correct irregular expenditure found by withdrawing it from payment claims and recovering any grant already paid from the beneficiaries;
- to monitor the implementation of the programme and send the Commission annual reports on performance, which are discussed with the Commission at annual meetings, and a final report summarising the implementation of the entire programme.

What checks does the Certifying Authority conduct before certifying expenditure to the Commission?

The Certifying Authority should not submit a payment claim to the Commission unless it is completely satisfied that proper controls have been carried out. It examines and assesses all the information it has received from the Managing Authority on its verifications of the beneficiaries and checks the data on the projects in the IT system, asking for clarifications where necessary. It also takes account of the available Audit Authority reports on the functioning of the control systems. While it should not duplicate the work of the Managing Authority, if necessary the Certifying Authority may also carry out additional checks itself or ask others to do so.

The second core level of control in the Member State is the Certifying Authority, whose function is to certify to the Commission that the expenditure being declared for reimbursement is accurate, results from a reliable accounting system, and complies with applicable Community and national rules. It receives the expenditure claims from the Managing Authority and carries out checks before it includes them in the certified claim for payment sent to the Commission.

First-level controls – the first line of defence

The day-to-day, first-level controls by Managing Authorities – ‘management verifications’ – are the foundation of the control system. They consist of comprehensive desk checks on documents such as lists of invoices and progress or final reports accompanying payment claims from project promoters, and on-the-spot visits to projects selected using a sound sampling methodology. The desk checks typically cover evidence that the project has delivered the investment, training or other services paid for and that the expenditure is correct, eligible and attributable to the project. During on-the-spot visits the controllers verify these elements and the fulfilment of other conditions of funding through physical inspections, interviews with staff and examination of accounts and documentary records including those relating to tendering procedures.
3.2 The role of audit

The audit work at national level verifies the effective functioning of controls by the Managing and Certifying Authorities in order to determine whether a risk remains that irregular expenditure might be certified. Where the audit work reveals deficiencies, the auditors issue recommendations. Accordingly, regular feedback is provided as to the effective functioning of the management and control systems. Audits by EU bodies examine the overall functioning of national control systems. Audits, however, cannot make up for ineffective first-level controls or lack of checking before certification of expenditure.

Audit Authority’s role – performing audits to build up assurance

The Audit Authority (or Audit Authorities) in the Member State has/have a key function in building up assurance in the system through the performance of the important responsibilities imposed by the regulations, at the beginning of the period, during implementation and at closure.

The Commission’s role – supervision

At EU level, the role of the Commission is to supervise the proper set-up and operation of the control systems in the Member States by means of:

- the compliance assessment procedure (see point 4), approval of audit strategies and scrutiny of annual control reports and audit opinions;
- carrying out audits on Member States to gain assurance that the systems are working effectively. The Commission focuses on the reliability of the work of the Audit Authorities to provide this assurance through their annual control reports and audit opinions. In addition, it targets the Managing Authorities and/or Certifying Authorities of high-risk programmes;
- monitoring information reported by Member States on irregularities and recoveries of unduly paid funds;
- providing formal guidance to establish benchmarks and spread good practices. Regulatory and control issues are discussed in the management committee composed of representatives of the Commission and Member States (the Coordination Committee of the Funds, COCOF), in the technical working group of the ESF Advisory Committee and in technical meetings with Audit Authorities; and
- checking at programme closure that the funding for the programmes is properly justified.

The Commission also supervises the management of programmes through its review of annual implementation reports, participation in monitoring committee meetings, where relevant information concerning the implementation of programmes is discussed, and scrutiny of payment claims.
The Commission’s services within the Directorates General for Regional Policy and Employment have a rolling audit strategy to obtain assurance on the effective set-up and functioning of the management and control systems over a period of years, based on the examination of information provided by Member States and the results of their own audits.

They provide an assessment of the effectiveness of the systems in different Member States and programmes in their Annual Activity Reports. The audit programme is established on the basis of risk assessment taking particular account of the amounts of EU funds at stake and risk factors relating to known weaknesses in the managing bodies and to the types of operations and beneficiaries. If corrective measures are not taken promptly by a Member State, the Commission may interrupt or suspend payments and apply financial corrections to recover previous payments liable to have been affected (see point 5).

**European Court of Auditors (ECA) – the external auditor**

Once a year, the European Court of Auditors delivers a ‘Statement of Assurance’ on the legality and regularity of EU revenue and expenditure in the various areas of the budget during the previous financial year. The assessments are based on audits carried out by the Court in the Member States and the Commission and are published in the Court’s annual report, together with the Commission’s replies.

To arrive at its annual assessment in the Cohesion Policy area, the Court audits a representative sample of around 180 projects in the Member States and also examines the effectiveness of the control systems operated in the Member States for the programmes concerned and the Commission’s supervisory work.

### 3.3 DAS and discharge

The European Parliament and the Council scrutinise the use of EU funds in the annual discharge procedure, which lasts from November to April, at the end of which Parliament votes on giving the Commission discharge on the accounts and the budget. The Court’s annual report, special reports and the replies by the Commission are the main source material for the discharge discussions. The Court’s assessment of the effectiveness of the control systems for Cohesion Policy expenditure over the 2000-06 budget period has been that they are not yet sufficiently effective, given the high rate of errors found in the expenditure reimbursed. The Court has not yet given its opinion on the effectiveness of control arrangements for the 2007-13 period. The European Parliament and European Council (Budgetary Authorities) also issue in the discharge procedure a series of recommendations addressed to the Commission and other stakeholders involved in managing EU funds. The Court follows up on the implementation of these recommendations and includes observations on progress made in subsequent reports to the Budgetary Authorities.

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1 Known as the ‘DAS’, from the French term ‘Déclaration d’Assurance’.
Why has Cohesion Policy not yet received a positive opinion from the European Court of Auditors, and what is being done?

Cohesion Policy expenditure is one of the most complex areas of the budget, with a high inherent risk which makes effective control a challenge.

There are reasons to think that the rate of error in expenditure from programmes in the 2007-13 period should be significantly lower because of the improvements in management and control systems during the previous period in many Member States, because of the clearer and more stringent control requirements introduced in the legislation for the 2007-13 period, and because of the verification of the set-up of systems through the compliance assessment process before any payments are made by the Commission.

In 2008/9 the Commission carried out an Action Plan to accelerate improvements for the new programmes and to ensure that irregular expenditure is removed from 2000-06 programmes before closure. The Action Plan, which closely followed the recommendations of the Court of Auditors, had a twofold strategy:

- to help Member States do a better job of checking the eligibility of project expenditure before they submit payment claims to the Commission;

- to take tougher measures to stop payments or claw back money if Member States fall below standards.

The Commission has also raised the question of what benchmarks in terms of error rates should be used by the Court of Auditors in assessing the effectiveness of systems in different policy areas (see ‘Towards a common understanding of the concept of tolerable risk of error’, COM(2008) 866). For Cohesion Policy programmes which are implemented over a nine-year period with controls which operate on a multi-annual basis, the objective is to ensure that by programme closure there is a very low level of error as, by that time, the expenditure would have passed through all levels of the management and control system.
The control system over time – how assurance is built up

Assurance on the effectiveness of control systems in preventing, detecting and correcting irregularities is built up throughout the whole programming period. The building blocks of assurance are illustrated in the following diagram.

**Ex ante – set-up of control system**

In the negotiations on the operational programmes, the Commission ensures that programme authorities are properly designated and any problems found with the systems in the previous period are adequately addressed.

After programme approval, the **compliance assessment** procedure gives assurance on the satisfactory set-up of control systems before any expenditure is reimbursed. Within 12 months of programme approval, a national audit body – often the Audit Authority – has to issue a certificate of compliance with regard to the internal control systems for the programme. The Commission looks at the compliance assessment report and opinion to make sure it is consistent and reliable. Only after any necessary corrective measures have been taken and the Commission is satisfied that the control system fully meets the regulatory requirements will it start to reimburse expenditure for the programme. At the beginning of the programme period, the Commission also examines and approves the audit strategy submitted by the Audit Authority within nine months of programme adoption.
During programme implementation

The Commission gains its assurance from the certification of expenditure by the Certifying Authority (see point 3.1) and the annual control report and audit opinion of the Audit Authority (see point 3.2), as well as from the results of its own audit work (see point 3.2).

Member States’ accountability

Another new element of the control system was introduced by the 2006 revision of the Financial Regulation governing EU funds. Member States, at an appropriate level in their central administration, have to submit by 15 February each year an ‘Annual Summary’ of the certifications by the Certifying Authority and the audit opinions by the Audit Authorities in relation to all programmes in the Member State for the previous calendar year. This is intended to reinforce the chain of accountability between Member States and Commission concerning the use of EU funds under shared management. Member States are recommended to express an opinion on the assurance provided by the management and control systems and to identify problems and their solutions. The annual summaries were provided for the first time in February 2008.

A few Member States are going further and providing voluntary ‘National Declarations’ at a political level, which are subject to audit by National Supreme Audit Institutions (SAIs). The Commission is encouraging this development, since such declarations can make a substantial contribution to the level of assurance it has on the functioning of national systems. SAIs cooperate with the European Court of Auditors on two main levels: 1) the regular meetings of the Heads of SAIs and ECA, and 2) the Contact Committee, the SAI and ECA Liaison Officers’ meeting. Working groups set up by the Contact Committee are the instruments for cooperation and exchange of information/experiences on specific issues. More information can be found on the Court’s website.

Ex post – the safety net of programme closure

At the end of the programme period, the Audit Authority reviews the audit work carried out and issues an opinion assessing the accuracy and compliance with the rules and conditions of the expenditure declared from the programme in the final statement of expenditure. In its closure report, the Audit Authority gives details of the action taken to improve systems and correct irregular expenditure in response to recommendations following its own audit work or that of the Commission and European Court of Auditors. The Commission carefully scrutinises all closure declarations and if necessary asks for further information or the performance of more audit work. It may carry out audits on a sample of programmes after closure.

Supporting documents have to be kept accessible for audit by the Commission, OLAF or the European Court of Auditors for three years after closure, i.e. up to 2017/18, except where the procedure of partial closure has been used, which reduces the document retention period for closed operations covered by the partial closure declaration.

2 http://eca.europa.eu/portal/page/portal/cooperation
What happens when problems are found?

5.1 Correction of irregularities is primarily the Member State’s responsibility

Non-compliance with the rules or conditions attached to EU funding will normally disqualify expenditure on a project from reimbursement or render it ‘irregular’. The beneficiary may then have to repay part or all of the grant received, depending on the nature and seriousness of the ‘irregularity’.

Such ‘irregularities’ are corrected by removing the irregular expenditure from payment claims submitted to the Commission and cancelling and recovering the grant from the beneficiary. The Member States’ authorities are responsible in the first instance for making corrections and recoveries. The Commission intervenes only when it establishes that irregular expenditure has not been corrected or that the control system for a programme is not working, with a consequent risk that irregularities are not being detected.

When the national authorities detect and correct an irregularity, they can re-use the EU funding released for other projects. This is an incentive to Member States to put in place effective systems. If the Commission has to make a correction, it involves a net reduction in the EU funding of the programme.

Irregularities

Typical irregularities are lack of supporting documents (for example, time records of staff, invoices or overhead allocation keys) which should be kept for the purposes of the audit trail, non-deduction of revenue from project expenditure, inclusion of ineligible expenditure such as recoverable VAT, and breaches of tendering requirements.

Only a minority of ‘irregularities’ involve fraud; the majority are due to negligence or unfamiliarity with the rules. That is why Managing Authorities are required, when granting project finance, to make sure that beneficiaries are aware of funding conditions and have the capacity to manage and carry out the proposed project.
Reporting of irregularities and financial corrections

Member States are required to report cases of irregularities involving more than €10,000 of EU funding at quarterly intervals to the Commission’s fraud prevention office, OLAF. Once a year they also have to provide the Commission with aggregate figures on all the financial corrections and recoveries they have made in the previous year, including those below the threshold for reporting to OLAF.

Trends in reported irregularities are analysed in the Commission’s annual report on the protection of the Communities’ financial interests under Article 280 of the Treaty. The Commission also publishes the figures for the financial corrections made by Member States. These figures provide evidence that the Member States’ control systems are working effectively.

5.2 What happens if the Commission detects failures in control systems?

When the Commission has evidence of significant deficiencies in the functioning of Member States’ management and control systems or of irregularities in relation to particular payment claims which a Member State has failed to prevent, detect or correct, it can interrupt or formally suspend payments to the programme concerned or open a financial correction procedure.

Financial corrections by the Commission

If the Member State fails to correct the irregularity or remedy the system deficiency, the Commission may apply a financial correction by formal decision. Such decisions always entail a net reduction in the EU funding of the programme, i.e. the Member State cannot re-use the cancelled EU funding for other projects.

The Commission can apply financial corrections on an extrapolated basis for systemic errors and flat-rate corrections for system failures or irregularities whose financial impact is difficult to quantify, for example in the public procurement area.

In the 2000-06 period (and also up to the end of 2008) some €3.15 billion of financial corrections were made as a result of audit work by the Commission, OLAF or the Court of Auditors, €2.6 billion of which were accepted by the Member States and implemented by them, the remaining €0.55 billion being applied by formal Commission decision.
The control system for Cohesion Policy
How it works in the 2007-13 budget period

To find out more…
Further, detailed information on the control system for Cohesion Policy and related areas can be found at http://ec.europa.eu/dgs/regional_policy/index_en.htm