



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 29.07.2002
C(2002) 2871

Guidelines
on the principles, criteria and indicative scales to be applied by Commission
departments in determining financial corrections under Article H(2) of Annex II
to Regulation (EC) No 1164/94 establishing a Cohesion Fund

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1. Principles

The purpose of financial corrections is to restore a situation where 100% of the expenditure declared for cofinancing from the Cohesion Fund is in line with the applicable national and EU rules and regulations. This allows the establishment of a number of key principles for the Commission services to apply in determining financial corrections :

- (a) Irregularity is defined in Article 1(2) of Regulation 2988/95. Irregularities can be one-off or systemic.
- (b) A systemic irregularity is a recurrent error due to serious failings in management and control systems designed to ensure correct accounting and compliance with rules and regulations.
 - If the applicable rules and regulations are respected, and all reasonable measures are taken to prevent, detect and correct fraud and irregularity, no financial corrections will be required.
 - If the applicable rules and regulations are respected, but the management and control systems need to be improved, there should be pertinent recommendations, but no financial corrections need be envisaged.
 - If there are serious failings in the management or control systems which could lead to systemic irregularities, in particular failures to respect the applicable rules and regulations, financial corrections should always be made.
- (c) The amount of the financial correction for individual or systemic irregularities is to be assessed wherever possible and practicable on the basis of individual files and to be equal to the amount of expenditure found to have been wrongly charged to the Fund in the cases investigated, having regard to the principle of proportionality.
- (d) There are situations where it is not possible or practicable to quantify the amount of irregular expenditure precisely, but it would be disproportionate to cancel the entire expenditure in question. In such cases, the Commission may determine corrections on the basis of extrapolation or at flat rates.
- (e) Extrapolation can be used where an examination of individual files reveals quantifiable irregularities of the same type and there is a high probability that the irregularity has occurred in a great number of similar cases, i.e., is systemic, but it is not practicable or cost-effective to investigate all the cases individually. Extrapolation requires that a homogeneous population of cases with the same characteristics can be clearly identified. The results of a thorough examination of a representative sample of transactions selected at random from the homogeneous population can then be extrapolated to all the files making up the population, in accordance with generally accepted auditing standards. A homogeneous population is defined as being within or among activities (projects or groups of projects) under the responsibility of the same managing authority, managed by the same implementing body in the same sector over the same time period, whether under a single Commission decision or different decisions.

- (f) Flat rate corrections may be applied in the case of individual breaches or systemic irregularities whose financial impact is not precisely quantifiable – being subject to too many variables or too diffuse in its effects – but where it would be disproportionate to refuse all the assistance concerned except in the most extreme cases. Such irregularities typically result from a failure to undertake checks effectively to prevent or detect breaches of Community rules or conditions of the decision. Where an irregularity appears to be systemic, a flat rate correction may be applied only to the cases investigated, or, in situations like those described in para. (e) above, it may be applied to a homogeneous population of cases with the same characteristics.
- (g) When proposing a flat rate correction, the Commission must assess the importance of the infringement of the rules and the extent and financial implications of any shortcomings in the management and control system that have led to the irregularity established.
 - A list of what the Commission considers to be key and ancillary elements of systems for the purpose of assessing the seriousness of deficiencies is given in section 2.2. and an indicative scale of flat rates for corrections in section 2.3. The same expenditure will not normally be subject to more than one correction.
- (h) In areas where there is a margin for discretion in evaluating the gravity of the infringement, as in cases of disregard of environmental conditions, corrections shall be subject to the following conditions : a significant failure to respect the rules and a clearly identifiable link with the action receiving EU cofinance.
- (i) Unlike the case with corrections made by the Member State under Article 39(1) of Regulation (EC) No 1260/1999, financial corrections decided by the Commission, whether under Article 39(3) of Regulation (EC) No 1260/1999 or Article H(2) of Annex II to Regulation (EC) No 1164/94, always involve a net reduction to the EU funding committed to the project or assistance.
- (j) Irrespective of the kind of corrections proposed by the Commission, the Member State is always given the opportunity to demonstrate that the real loss or risk to the Fund and the extent or gravity of the irregularity was less than that assessed by the Commission services. The Court of Justice has held that the burden of such proof is on the Member State.¹ The procedure and time limits are set out in Article 18 of Regulation (EC) No XX/2002.
- (k) Where the Commission bases its position on facts established and fully documented by auditors other than those of its own services, it shall draw its own conclusions regarding their financial consequences, after examining the measures taken by the Member State concerned under Article 12(1) and (2) of Regulation (EC) No 1164/94 and Article G(1) of Annex II thereto, the reports supplied under Article 12 of Regulation (EC) No XX/2002 and Regulation (EC) No 1831/94, and any replies from the Member State.

¹ See judgment of ECJ of 21.1.1999 in Case C-54/95, Germany v. Commission, para. 35, referring also to Netherlands v. Commission, Case C-48/93.

- (1) In all cases of corrections by extrapolation or on a flat-rate basis, the proposed correction is submitted to an ad hoc advisory panel, which will consider the arguments presented by the Commission auditor for applying the correction and assess whether the level is appropriate.

2. CRITERIA AND SCALES FOR FLAT-RATE CORRECTIONS

2.1 Criteria

As noted in para. 1(f) above, flat-rate corrections may be envisaged when the information resulting from the enquiry does not permit the financial impact of an individual case or several cases of irregularities to be evaluated precisely by statistical means, or by reference to other verifiable data, but does lead to the conclusion that the Member State has failed to carry out adequate verification of the eligibility of claims paid.

Flat-rate corrections should be considered when the Commission finds a failure to adequately effect any control which is explicitly required by a regulation, or implicitly required in order to respect an explicit rule, and whose absence could lead to systemic irregularity. They should also be considered where the Commission finds serious deficiencies in management and control systems resulting in breaches of applicable rules and regulations on a wide scale or detects individual breaches. In determining whether a flat-rate financial correction should result and, if so, at what rate, the general consideration shall be the assessment of the degree of risk of loss to which Community funds were exposed as a consequence of the control deficiency. Thus the correction should be in compliance with the principle of proportionality. The specific elements to be taken into account should include the following:

- (1) whether the irregularity is related to an individual case, multiple cases or all cases;
- (2) whether the deficiency relates to the effectiveness of the management and control system generally, to the effectiveness of a particular element of the system, i.e. the operation of particular functions necessary to ensure the legality, regularity and eligibility of expenditure declared for cofinancing from the Fund under the applicable national and EU rules (see section 2.2. below);
- (3) the importance of the deficiency within the totality of the administrative, physical and other controls foreseen;
- (4) the vulnerability to fraud of the measures, having regard particularly to the economic incentive.

- 2.2. Classification of elements of management and control systems for the purpose of applying flat rates of financial corrections for system deficiencies or individual breaches

Management and control systems for the Cohesion Fund consist of various elements or functions of greater or lesser importance for ensuring the legality, regularity and eligibility of expenditure declared for cofinancing. For the purpose of assessing flat rate corrections for deficiencies in such systems or individual cases of irregularity, it is useful to classify the functions of management and control systems into key and ancillary elements.

Key elements are those designed and essential to ensure the legality and regularity and indeed the substance of operations supported by the Fund, ancillary elements those that contribute to the quality of a management and control system and help ensure that the system keeps performing well in relation to its key functions.

The list below contains the majority of elements of good management and control systems and good audit practice. The seriousness of deficiencies and individual breaches varies considerably, and cases will therefore be assessed by the advisory panel having regard, in particular, to section 2.4 below.

2.2.1 Key elements for ensuring eligibility for cofinancing

1. Provision and application of procedures for ensuring :

a) at the planning and design stage

- compliance, where applicable, with national and EU rules on publicity, public procurement and environmental protection, and with the general Treaty rules and principles of transparency, equality of treatment and non-discrimination where EC public procurement directives are not applicable;
- adequacy of preliminary and technical studies

b) in the pre-selection of projects for funding, especially within groups of projects:

- projects selected correspond to the objectives and published criteria;
- observance of eligibility rules;

c) selection of contractors/suppliers in according with public procurement rules.

2. Adequate verification of delivery of products and services and of eligibility of expenditure

- on the part of the implementing body :

- (a) verifying the reality of “deliverables” (services, works, supplies, etc.) against plans, invoices, acceptance documents, experts’ reports, etc., and, where appropriate, on the spot;

- (b) verification of observance of conditions of grant approval and of the procedures for changing those conditions;
- (c) verification of eligibility of amounts claimed;
- (d) adequate follow-up of all outstanding questions before acceptance of claim;
- (e) maintenance of an adequate and reliable accounting system;
- (f) maintenance of the audit trail at all levels from the implementing body or body or firm carrying out operation up through the system.

- on the part of the paying authority

Taking reasonable measures to obtain assurance that the declarations of expenditure it certifies to the Commission are correct, and that:

- (a) expenditure was effected within the eligibility period laid down in the decision of the Commission;
- (b) the cofinanced activities have actually been carried out.

3. Sufficient quantity and quality of sample checks on projects and adequate follow-up

- a) carrying out sample checks on at least 15% of total eligible expenditure in accordance with Article 9 of Regulation xxx/2002, supported by a report on the work done by the auditor;
- b) the sample is representative and the risk analysis adequate;
- c) adequate separation of functions vis-à-vis bodies involved in the implementation of projects to ensure independence ;
- d) follow-up to checks, ensuring
 - (a) appropriate assessment of results and notification of irregularities under Regulation (EC) 1831/94,
 - (b) action at a general level to correct systemic irregularities
- e) adequate examination underlying declaration on closure under Article 13 of Regulation (EC) xxx/2002

2.2.2 Ancillary elements

- a) satisfactory administrative controls in the form of standard checklists or equivalent means and proper documentation of results, to ensure for instance :
 - that claims have not been paid before and transactions (contracts, receipts, invoices, payments) are separately identifiable;

- reconciliation within the accounting system of declarations and expenditure recorded;
- b) proper supervision of payment processing and authorisation procedures;
- c) satisfactory procedures to ensure proper dissemination of information about EU rules;
- d) ensuring timely payment of Community funding to beneficiaries.

2.3 Indicative scales of flat-rate corrections

100% correction

The rate of correction may be fixed at 100% when the deficiencies in the management and control system are, or an individual breach is, so serious as to constitute a complete failure to comply with Community rules, so rendering all the payments irregular.

25% correction

When the management and control system is gravely deficient and there is evidence of widespread irregularity and negligence in countering irregular or fraudulent practices, a correction of 25% is justified, as it can then reasonably be assumed that the freedom to submit irregular claims with impunity will occasion exceptionally high losses to the Fund. A correction at this rate is also appropriate for irregularities in an individual case which are serious but do not invalidate the whole project.

10% correction

When one or more key elements of the system do not function in the cases concerned or function so poorly or so infrequently that they are completely ineffective in determining the eligibility of the claim or preventing irregularity, a correction of 10% is justified, as it can reasonably be concluded that there was a high risk of widespread loss to the Fund. This rate of correction is also appropriate for individual irregularities of moderate seriousness in relation to key elements of the system.

5% correction

When all the key elements of the system function in the cases concerned, but not with the consistency, frequency, or depth required by the regulations, then a correction of 5% is justified, as it can reasonably be concluded that they do not provide a sufficient level of assurance of the regularity of claims, and that the risk to the Funds was significant. A 5% correction can also be appropriate for less serious irregularities in individual transactions in relation to key elements.

The fact that the way in which a system operates is perfectible is not in itself sufficient grounds for a financial correction. There must be a serious deficiency of compliance with explicit Community rules or standards of good

practice and the deficiency must expose the Cohesion Fund to a real risk of loss or irregularity.

2% correction

When performance in the cases concerned is adequate in relation to the key elements of the system, but there is a complete failure to operate one or more ancillary elements, a correction of 2% is justified in view of the lower risk of loss to the Fund and the lesser seriousness of the infringement.

A 2% correction will be increased to 5% if the same deficiency is established in relation to expenditure after the date of the first correction imposed and the Member State has failed to take adequate corrective measures for the part of the system at fault after the first correction.

A correction of 2% is also justified where the Commission has informed the Member State, without imposing any correction, of the need to make improvements to ancillary elements of the system that are in place but do not operate satisfactorily, but the Member State has not taken the necessary action.

Corrections are only imposed for deficiencies in ancillary elements of management and control systems where no deficiencies have been identified in key elements. If there are deficiencies in relation to ancillary elements as well as in key elements, corrections are only made at the rate applicable to the key elements.

2.4 Borderline cases

Where the correction resulting from a strict application of these guidelines would be clearly disproportionate, a lower rate of correction may be proposed. The advisory panel referred to in para. 1 l) will give careful consideration to the proportionality of corrections.

For example, where the deficiencies arose from difficulties in the interpretation of Community rules or requirements (except in cases where it should reasonably be expected that the Member State raise such difficulties with the Commission), and the national authorities took effective steps to remedy the deficiencies as soon as they were brought to light, this mitigating factor may be taken into account and a lower rate or no correction may be proposed. Similarly, due regard should be paid to claims of legal security when the deficiencies were not reported following earlier audits by the Commission's services.

In general, the fact that deficient management or control systems were improved immediately after the deficiencies were reported to the Member State is not considered as a mitigating factor when assessing the financial impact of the systemic irregularities before the improvement was made.

2.5 Basis of assessment

Whenever similar cases have arisen in other Member States, there should be a comparison between them to ensure equal treatment in the assessment of the rates of correction. This is a prime objective of the advisory panel.

The rate of correction should be applied to that part of the expenditure placed at risk. When the deficiency results from a failure by the authorities concerned to adopt an appropriate control system, then the correction should be applied to the entire expenditure for which that control system was required. The correction should normally concern the expenditure over the period being examined, for example one financial year. However, when the irregularity results from systemic deficiencies, which are evidently long-standing and affecting several years' expenditure, then the correction should concern all the expenditure declared by the Member State while the system deficiency obtained until the month in which it was remedied.

When several deficiencies are found in the same system, the flat rates of correction are not cumulated, the most serious deficiency being taken as an indication of the risks presented by the control system as a whole². They are applied to the expenditure remaining after deduction of the amounts refused for individual files. In the case of the Member State's non-application of sanctions prescribed by national law, the financial correction should be the amount of the sanctions not applied, together with 2% of the remaining claims, as the non-application of sanctions increases the risk that irregular claims will be submitted.

² See also section 2.3 (2% correction).