EGESIF_15-0007-02 final
09/10/2015

EUROPEAN COMMISSION

European Structural and Investment Funds

Updated Guidance for Member States on treatment of errors disclosed in the annual control reports

(Programming Period 2007-2013)

(Annex to the Guidance on ACRs and Opinions:
COCOF 09/0004/01-EN of 18/02/2009 and EFFC/0037/2009-EN of 23/02/2009)

DISCLAIMER: *This is a document prepared by the Commission services. On the basis of the applicable EU law, it provides technical guidance to colleagues and other bodies involved in the monitoring, control or implementation of the European Structural and Investment Funds (except for the European Agricultural Fund for Rural Development (EAFRD)) on how to interpret and apply the EU rules in this area. The aim of this document is to provide Commission's services explanations and interpretations of the said rules in order to facilitate the programmes' implementation and to encourage good practice(s). This guidance note is without prejudice to the interpretation of the Court of Justice and the General Court or decisions of the Commission.*

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LIST OF ACRONYMS AND ABBREVIATIONS

AA	Audit Authority
AAR	Annual Activity Report (of each Directorate-General of the Commission)
ACR	Annual Control Report
CA	Certifying Authority
CF	Cohesion Fund
COCOF	Committee of the Coordination of the Funds
DAS	Declaration of Assurance from the European Court of Auditors on the implementation of the EU budget
EFF	European Fisheries Fund
ERDF	European Regional Development Fund
ESF	European Social Fund
IB	Intermediate Body
ISA	International Standard of Auditing
MA	Managing Authority
MCS	Management and Control System
MUS	Monetary Unit Sampling
TPER	Total Projected Error Rate

GLOSSARY

Term	Definition
Anomalous error	A misstatement that is demonstrably not representative of the population. The existence of anomalous errors should only be reported in extremely rare, well-motivated circumstances.
Audit period	The audit authority has to report on the basis of the audit work carried out during the audit period 01/07/N to 30/06/N+1 by 31/12/N+1. The audit period is the period during which the AA carries out its work, both systems audits and audits of operations.
Contradictory procedure	Procedure whereby (draft) audit reports are sent to the auditee with a request for a written reply within a given time-limit.
Error	For the purposes of this guidance, an error/irregularity/misstatement is a quantifiable overstatement of the expenditure certified declared to the Commission.
Expenditure of year N	Expenditure declared to the Commission, on the basis of which the sample of operations is selected.
Irregularity	Same meaning as error or misstatement.
Known error	A known error is an error found outside the sample audited.
Misstatements	Same meaning as error or irregularity.
Population	The entire set of data from which the sample is selected (for the purposes of Article 62.1(b) of Regulation (EC) N° 1830/2006) and about which the auditor wishes to draw conclusions.
Random error	The errors which are not considered systemic are classified as random errors. This concept presumes the probability that random errors found in the audited sample are also present in the non-audited population.

Term	Definition
Residual error rate (RER)	Residual Error Rate (RER) corresponds to the TPER less the financial corrections that may have been applied by the Member State in relation to the errors detected by the AA in its audits of operations, including projected random errors or systemic irregularities. Usually, these corrections are applied after the TPER is determined. However, financial corrections applied by the Member State after the AA drew its sample and before the TPER has been established by the AA may also be deducted from the RER, provided that such corrections intend to reduce the risks identified by the TPER. Further details on the RER are presented in section 5.1 of this guidance.
Systemic error	The systemic errors are: - errors found in the sample audited; and - have an impact in the non-audited population; - occur in well-defined and similar circumstances. These errors generally have a common feature, e.g. type of operation, location or period. They are in general associated with ineffective control procedures within (part of) the management and control systems.
Total projected error rate (TPER)	The total projected error corresponds to the sum of the following errors: projected random errors, systemic errors and anomalous errors. The AA should compare the total projected error rate with the materiality threshold in order to reach conclusions for the total population covered by the sample.

1. INTRODUCTION

This document aims to provide guidance to Member State's authorities, namely AAs, by clarifying the main questions raised by them during the programming period 2007-2013 in relation to the treatment and evaluation of the errors detected in the context of their audits of operations. The guidance also provides clarifications on the calculation of the total projected error rate, the related corrective measures and the impact in AA's audit opinion submitted under Article 62(1)(d)(ii) of Regulation (EC) No 1083/2006 and Article 61(1)(e)(ii) of Regulation (EC) No 1198/2006.

This document is an update of the Commission's guidance notes COCOF 11-0041-01-EN of 07/12/2011 and EFFC/87/2012 of 09/11/2012, taking into account the lessons learnt since then trough the assessment of the 2012, 2013 and 2014 ACRs. This guidance consolidates in one document the clarifications provided to AAs since 2011, with the appropriate update where considered necessary. Annex 3 presents a table comparing the structure of the previous and the updated guidance on treatment of errors. This guidance is the basis for the guidance on treatment of errors for the programming period 2014-2020, to be released.

The guidance is a joint document prepared by the Directorate-General of Regional and Urban Policy in cooperation with the Directorate-General for Employment, Social Affairs and Equal Opportunities and DG Maritime Affairs. As such, the guidance is to be applied by AAs responsible for providing an ACR for programmes co-financed by ERDF, CF, ESF or EFF.

This guidance is to be seen as complementary and should be read with existing Commission guidelines, namely the following:

– Guidance on ACRs and Opinions for the Structural Funds and Cohesion Fund (COCOF 09/0004/01-EN of 18/02/2009 and EFFC/0037/2009-EN of 23/02/2009), hereafter "Guidance on ACRs and Opinions";

– Guidance note on sampling methods for Audit Authorities of 04/04/2013 (COCOF 08/0021/03-EN), hereafter "Guidance on sampling";

– Guidance on a common methodology for the assessment of management and control systems [MCS] in the Member States"[1] (COCOF 08/0019/00-EN of 06/06/2008 and EFFC/27/2008 of 12/09/2008), hereafter "Guidance for the assessment of MCS";

– Guidance note to Certifying Authorities on reporting on withdrawn amounts, recovered amounts, amounts to be recovered and amounts considered irrecoverable, applicable to programming period 2007-2013, of 27/03/2010 (COCOF N° 10/0002/00/EN), hereafter "Guidance to CA".

[1] See COCOF note 08/0019/00-EN, in which four categories for the assessment of the systems are foreseen: Category 1: Works well; only minor improvements needed (high reliability), category 2: works but some improvements are needed (average reliability), category 3: works partially; substantially improvements are needed (average reliability), category 4: essentially does not work (low reliability).

2. EVALUATION OF ERRORS

2.1. Overview of type of error

As required by the international audit standards, namely ISA 530, the ACR should present the evaluation of errors detected in the context of the AA's audits of operations, in addition to the corrective measures (see section 5 below). The errors detected in those audits may be random, systemic or, in exceptional circumstances, anomalous. These concepts are explained in sections 2.2, 2.3 and 2.5 below.

Following the evaluation of errors, the AA should calculate the TPER, as explained in section 2.5 below. The AA should strive to plan its work so that the evaluation is properly done and the corrective measures may be taken by the Member State in time before submission of the ACR. The professional judgment used by the AA for the evaluation of errors should be explained in the ACR.

2.2. Systemic errors

Systemic errors are errors found in the sample audited that have an impact in the non-audited population and occur in well-defined and similar circumstances. They are in general associated with ineffective control procedures within (part of) the management and control systems. Indeed, the identification of a potential systemic error implies carrying out the complementary work necessary for the identification of its total extent and subsequent quantification. This means that all the situations susceptible of containing an error of the same type as the one detected in the sample should be identified, thus allowing the delimitation of its total effect in the population[2]. According to Article 98(4) of Regulation (EC) N° 1083/2006 and Article 96(4) of Regulation (EC) N° 1198/2006, *"in the case of a systemic irregularity, the Member State shall extend its enquiries to cover all operations liable to be affected"*.

If the AA has reasonable assurance that the part of the population affected by systemic errors is fully delimited and there are no other units in the population susceptible to be affected by similar errors, the amount of systemic errors should be added to the random projected error in order to produce the TPER. Extrapolating the random errors found in the sample to the population requires that the AA use the formulas set out in the appendix 1 of the Guidance on sampling.

The amount of systemic errors found in the sample is not considered nor accounted for in the random projected error, but added to it for the purpose of calculating the TPER (cf. section 2.5). Nevertheless, any random error found in the operations affected by systemic errors (in addition to the systemic error(s)) should be extrapolated and accounted for in the random projected error.

A particular type of error that should not be confounded with systemic errors exists when an error found in one operation in the sample leads the auditor to detect one or

[2] For example, it can be that a certain error has been detected in an operation co-financed under a priority axis relating to financial engineering. It may be that this error occurs in other operations in the same priority axis. The AA needs to determine if this is the case, in cooperation with the Managing Authority.

more errors outside that sample in the same operation– this can be classified as a "known error". For example, if a contract is found to be illegal under the public procurement rules it is likely that part of the related irregular expenditure has been declared for that operation in a payment claim or invoice included in the sample audited. The remaining expenditure for that operation may have been declared in payment claims or invoices not included in that sample, within the audited population or in previous year's population.

The recommended approach to deal with known errors is to extrapolate the random errors in the sample (including the error that led to the detection of the known error) to the total expenditure (without deducting the amount of known errors from the population). In this case, the known error is not added to the TPER. This recommendation results from the fact that, contrary to systemic errors, the delimitation of the known error is usually done at the level of the operation where the error was detected. This process does not provide confirmation whether other operations affected by this type of error remain in the population. In this context, the known error should be corrected as any other type of error. The known errors concerning previous years should also be corrected.

2.3. Random errors

Following the evaluation of errors by the AA, the errors which are not considered systemic are classified as random errors. This concept presumes the probability that random errors found in the audited sample are also present in the non-audited population, since the sample is representative. Hence, these errors are to be included in the projection of errors – see section 2.5 of this guidance.

The calculation of the projection of random errors differs according to the sampling method selected, as described in the guidance on sampling.

2.4. Anomalous errors

An error that is demonstrably not representative of the population is called anomalous error. A statistical sample is representative for the population and therefore anomalous errors should only be reported in extremely rare, well-motivated circumstances. The frequent recourse to this concept without a due justification may undermine the reliability of calculation of the TPER and the AA´s audit opinion.

The AA is required to provide in the ACR a high degree of certainty that such an anomalous error is not representative of the population and to explain the additional audit procedures it carried out to conclude on the existence of an anomalous error, as required by the ISA n° 530, that further specifies:

> *"A.19. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements".*
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> *A.22. In the case of tests of details, the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population. When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not*

provide a reasonable basis for conclusions about the population that has been tested. (...)"

This means that, when the AA decides to exclude an anomalous error from the calculation of the projected error, the amount of the anomalous error is to be added in the calculation of the TPER if it has not been corrected, in accordance with section 5.1 of this guidance. If the anomalous error has been corrected before the ACR concerned is submitted to the Commission, then it does not count for the TPER. This approach is only applicable to anomalous errors given their exceptional nature, as foreseen in the quoted audit standard.

A particular case may occur when the AA finds an irregularity in an operation (e.g. non-compliance with public procurement rules concerning a specific contract) while the same operation is also affected by an anomalous error. In this case, the random error should be projected to the population; the anomalous error in that same operation is added to the TPER, unless corrected before the ACR is submitted. This is because the random error is representing other possible errors in the population and should be extrapolated to the remaining expenditure of the population in order to properly estimate the TPER.

2.5. Total Projected Error Rate

The AA should disclose in the ACR the TPER, to be compared with the materiality threshold in order to reach a conclusion on whether the population from which the random sample was selected is materially misstated or not[3]. The TPER represents the estimated effect of the errors in the management and control systems, in percentage of the population for the year N. The total projected error should reflect the analysis done by the AA in regard to the errors detected in the context of the audits of operations carried out under Article 62.1(b) of Regulation (EC) N 1083/2006 and Article 61.1(b) of Regulation (EC) No 1198/2006.

The TPER corresponds to the sum of the relevant components (i.e. projected random errors, systemic errors and uncorrected anomalous errors) divided by the population of year N – see flowchart in Annex 1 of this guidance.

If systemic errors are identified in the audited sample and their extension in the population not audited is delimited with precision, then the systemic errors relating to the population are added to the total projected error, as mentioned above. If such delimitation is not done before the ACR is submitted, the systemic errors concerned are to be treated as random for the purposes of the calculation of the projected random error.[4]

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[3] As follows from the second subparagraph of Article 17(4) of Commission Regulation (EC) No 1828/2006 and the second subparagraph of Article 43(4) of Commission Regulation (EC) No 498/2007: *"in operational programmes for which the projected error rate is above the materiality level, the audit authority shall analyse its significance and take the necessary actions, including making appropriate recommendations, which will be communicated in the annual control report".*

[4] The errors found during systems audits (control testing) are not added to the total projected error, but should be corrected and disclosed in section 4 of the ACR. The conclusions drawn from systems audits should be taken into account in the audit opinion disclosed in the ACR, together with the outcome of the audits of operations.

3. COMMON SYSTEMS AND DIFFERENT AUDIT OPINIONS BY PROGRAMME

The information on the TPER should be presented in the ACR section concerning audits on sample of operations. In addition, the "table for declared expenditure and sample audits" to be attached to the ACR (as follows from table 9 of Annex VIII of Regulation (EC) N° 1828/2006) should disclose the TPER – see Annex 2 to the present document.

The ACR is submitted to the Commission via SFC2007. The module in SFC2007 includes the above-mentioned table, which is filled in by the AA. The information on the TPER is to be inserted in a separate column, after the column entitled "amount and percentage (error rate) of irregular expenditure in random sample".

While it is methodologically correct to report the TPER covering the programmes included in a common MCS, it may not be always true that the opinion is the same for all the programmes of that system.

Article 62(1)d of Council regulation (EC) No 1083/2006 refers that "*When a common system applies to several operational programmes, the information referred to in point (i) may be grouped in a single report, and the opinion and declaration issued under points (ii) and (iii) may cover all the operational programmes concerned*" [emphasis added].

Therefore, if system audits or the analysis of the errors detected in the random sample for a common MCS show particular deficiencies for one single programme included in that common system, the AA may consider differentiating its audit opinion for that particular programme. As such, SFC2007 allows the AA to insert different opinions for each programme, even if they belong to the same MCS. In this case, the AA should explain in the ACR the audit evidence that supports the different audit opinions for the programme(s) singled out from the assessment of the common MCS to which they belong.

In order to have sufficient audit evidence enabling the AA to draw differentiated audit opinions for the programmes included in a common MCS (also in view of closure[5]), the Commission recommends that, when different results are expected for some of those programmes, the AA plans its work in order to seek reasonable assurance for the specific programme(s). This can be achieved by ensuring a representative stratum covering the respective expenditure declared. Where statistical sampling is used to select the random sample for the common MCS, the rule of thumb of at least 30 sampling units for that stratum applies. For non-statistical sampling, the options presented in the guidance on sampling are applicable.

[5] At closure, there will be a need to have sufficient audit assurance for each programme, cf. 1st paragraph of Article 17(5) of Regulation (EC) No 1828/2006 (for ERDF, CF and ESF) and Article 43(5) of Regulation (EC) No. 498/2007 (for EFF).

4. INADEQUATE AUDIT OPINIONS

Among others, the Commission considers the following cases as inadequate audit opinions:

- unqualified opinions although no audits of operations on the year N expenditure were carried out;
- unqualified opinion even though the AA has not audited all the operations in the sample;
- unqualified opinions although the total projected error rates were above the materiality level, and/or significant weaknesses had been detected in the system audits, without the appropriate corrective measures (cf. section 5 of this guidance) being taken by the national authorities in time before the disclosure of the audit opinion;
- disclaimer of opinion because the contradictory procedures for audits of operations were not finalised.

5. CORRECTIVE MEASURES

5.1. Concept of corrected error for determining the audit opinion

All errors should be corrected, including the random, systemic and anomalous errors[6].

For the purposes of an unqualified audit opinion, the expenditure declared to the Commission should be corrected so that the RER for the expenditure of the year under review is below or equal to 2% and the identified system weaknesses are mitigated to an appropriate level to ensure the prevention of errors in future declarations of expenditure.

The RER corresponds to the TPER less the financial corrections that may have been applied by the Member State in relation to the errors detected by the AA in its audits of operations, including projected random errors or systemic irregularities. Usually, these corrections are applied after the TPER is determined. However, financial corrections applied by the Member State after the AA drew its sample and before the TPER has been established by the AA may also be deducted from the RER, if such corrections intend to reduce the risks identified by the TPER. A typical example would be when there are corrections made on the basis of MA's work carried out when determining the extent of systemic irregularities detected by the AA in its audits of operations. In any case, besides the professional judgement applied by the AA when considering the financial corrections to be considered in the calculation of the RER, the AA should have reasonable assurance that the financial corrections to be considered in the RER are indeed corrections of irregular expenditure and not, for example, corrections of clerical mistakes, reversal entries in the accounts not corresponding to financial corrections, revenues of revenue-generating projects, transfer of operations from one programme to another (or

[6] Concerning known errors, see last two paragraphs of section 2.2 above.

within a programme) or management decisions to cancel a project and which are unrelated with irregularities found in that project. Finally, the corrections related with individual irregularities[7] not included as such in the TPER (e.g. the particular cases of anomalous errors corrected before submission of the ACR, irregularities already detected and acted upon by the IB/MA/CA but not yet corrected before the sample was drawn by AA[8]) should not be counted for in the RER, in order to avoid its underestimation.

Pursuant to Article 70 of Regulation (EC) No 1083/2006 and Article 70 of Council Regulation (EC) No 1198/2006, Member States (MA or CA, in accordance with the MCS) are required to correct and recover amounts unduly paid. Member States have two choices:

- withdrawing the irregular expenditure from the programme immediately when they detect the irregularity, by deducting it from the next statement of expenditure, thereby releasing EU funding for commitment to other operations or

- leaving the expenditure for the time being in the programme, pending the outcome of proceedings to recover the unduly paid grant from the beneficiaries, and deducting the expenditure from the next statement of expenditure only once recovery from the beneficiary has been effected.

For the purposes of the audit opinion, an error is considered corrected in the following cases:

1) when the irregular amount has been deducted (via a withdrawal or a recovery) from an application for interim payment submitted to the Commission before the ACR is finalized; or

2) when the expenditure at stake has been (or is being) corrected at national level (before the ACR is finalized) by one of three means:

a) formal commitment by the competent body (MA or CA), notified to the AA and/or the Commission, stating that the irregular expenditure will be corrected in the subsequent application for interim payment;

b) withdrawal registered at national level in the Certifying Authority's accounting and monitoring system;

c) the Member State has initiated the procedure to recover the irregular expenditure from the beneficiary(ies) [9].

7 An individual irregularity is a one-off error which is independent of other errors in the population or deficiencies in the systems, cf. section 1.4 of the Commission Decision of 19.10.2011 on the "approval of guidelines on the principles, criteria and indicative scales to be applied in respect of financial corrections made by the Commission under Articles 99 and 100 of Council Regulation (EC) N° 1083/2006 of 11 July 2006".

8 Under the conditions explained in section 7.1.1 of this guidance.

9 This means that a recovery order has been issued by the responsible body.

The AA should be informed on the effective corrections made.

5.2. Corrective measures as subsequent events

Based on the analysis of the results of the systems audits and of the audits on operations reported by the AA, the Member State (MA or CA in accordance with the MCS) needs to take the necessary corrective, follow-up measures.

The existence of a TPER above the materiality level in case of a MCS classified in category 3 or 4 confirms the existence of serious deficiencies in that system. In this case, in order to mitigate the risk of material errors in future declarations of expenditure, the responsible authorities should commit to implement a remedial action plan with strict deadlines addressing the systemic deficiencies. The action plan should be described clearly and concisely in the ACR. This action plan can only be considered by the AA as a subsequent event and therefore their impact taken into account when drawing up the audit opinion, if the actions have been effectively implemented and the AA has clear evidence thereof.

If the corrective measures are implemented before the ACR is submitted to the Commission and the AA has sufficient evidence thereof (cf. section 5.1), such corrective measures can be considered as subsequent events which have occurred after the audit period. Such subsequent events should be reported in the ACR, to demonstrate that the detected errors have been appropriately followed-up by the national authorities. The AA can take those events into account when establishing the level of assurance and audit opinion. As foreseen in the guidance on ACR[10], "*some subsequent events might have an important impact on the functioning of management and control systems and/or on the qualifications (in cases of qualified or adverse opinion) and therefore cannot be ignored by the audit authority*". These events may correspond either to positive actions (e.g. corrective measures implemented after the audit period) or negative impact of a new situation (e.g. deficiencies in the system or errors detected after the audit period).

If the corrective measures concern correction of irregular expenditure, such corrections can only be considered by the AA for the purposes mentioned in the previous paragraph if the related expenditure has been corrected in accordance with section 5.1 above.

5.3. Correction of each type of error

For the Commission, correction of each type of error is the preferred option in presence of systemic errors. Indeed, in this case, the analysis and correction of each type of error is the one that adheres more to the evaluation of errors required by the international audit standards, namely ISA 530. Consequently, the AA should strive to plan its work so that this option can be applied by the Member State in time before submission of the ACR.

As mentioned above in section 2.2, the AA should evaluate the errors found in its audits of operations. Where systemic errors are detected and for the purpose of the ACR, the AA should confirm the following:

[10] See section 8 of the Guidance on ACRs and Opinions.

1) The total amount of expenditure declared to the Commission affected by those systemic errors is determined and the responsible authorities proceed to the necessary financial correction as soon as possible. The delimitation of the systemic error in the non-audited expenditure can be performed by the MA, under the supervision of the AA. In practice, this supervision implies that the AA has to review the quality of the MA's work and provide explicit confirmation in the ACR that the work has been carried out to the appropriate standard and that the conclusions are appropriate.

2) In order to mitigate the risk of material errors in future declarations of expenditure, the responsible national authorities should commit to implement a remedial action plan with strict deadlines addressing the systemic deficiencies. The action plan should be described clearly and concisely in the ACR.

Random errors can be either the sole source of error identified in the audited sample or exist in addition to systemic errors. The AA should calculate the expenditure at risk by applying the projected error rate (relating to the random errors found in the sample of operations audited and calculated taking account of appendix 1 of the Guidance on sampling) to the population concerned by the random errors. This should be done using the formula mentioned below in section 5.4.

5.4. Extrapolated financial correction[11]

Where the analysis of the errors detected in the AA's audits of operations has not identified systemic or anomalous errors (or when that evaluation was not completed in time for the ACR), the Member State[12], after obtaining the TPER, may decide to eliminate irregular expenditure declared to ensure a residual error rate of less than or equal to 2%.

This would enable the AA, subject to the criteria outlined in section 6 below, to issue an unqualified opinion, provided that the AA can confirm in the ACR that the deficiencies in the MCS which produces the errors above the materiality have been solved or corrective measures have been taken as described above in sections 5.2 and 5.3.

Where an extrapolated financial correction is applied on the basis of the projected random error rate (where the total projected error rate is only constituted by random errors), the projected error rate is applied to the whole population. The resulting amount is then reduced by the errors detected in the sample (to be corrected separately[13]), which will correspond to the amount of the required extrapolated

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[11] This is without prejudice of further assessment by the Commission, where the Cumulative Residual Risk at the time of the ACR and of the multi-annual period is above 2%. In this case, the Commission may request further corrective measures since this may indicate that the MCS of the programme(s) in question has(have) not yet corrected the risks identified by the AA throughout the lifetime of the programme(s).

[12] The MA or the CA in accordance with the MCS.

[13] Errors in the sample are corrected only once.

correction. This assumes the simplest scenario where no systemic errors have been detected by the AA in the context of its audits of operations[14].

Under the premises above-mentioned, the Commission would consider an extrapolated financial correction to be appropriate when it is calculated within the limits of the interval between A and B:

A: Extrapolated financial correction = Projected random error - Errors in the sample
B: Extrapolated financial correction = Projected random error – (Population*2%) - Errors in the sample

Example:
Projected rate for random errors: 4%
Population: 1 000 Million €
Errors in the sample (already corrected): 3 Million €
Correction of between 37 Million € and 17 Million €:
A: 37 Million €= (4% * 1000 Million €) - 3 Million €
B: 17 Million €= (4% * 1000 Million €) – (2% * 1000) - 3 Million €

6. TPER AND THE ASSURANCE ON THE EFFECTIVE FUNCTIONING OF THE MCS

For the purposes of the audit opinion to be drawn-up by the AA, the assurance on the proper functioning of the MCS is based on the combined results of both the system audits and the audits of operations.

As set out in Annex VII of the Regulation (EC) No 1828/2006 and as mentioned in section 8 of the Guidance on ACRs and Opinions of 2009, in case of a qualified opinion, the AA is required to provide an estimate of the impact that this qualification. That guidance further describes that "*the quantification of the impact may be done either on the basis that the projected error rate established for expenditure in the reference year is applicable, or on a flat-rate basis, taking into account all the information that the AA may have at its disposal*". The AA may also describe in the relevant paragraph of the opinion whether the impact of the qualifications are limited or significant.

The quantification of the impact may be done either on the basis of the TPER (or the RER, where corrective measures have been implemented by the Member State before the

[14] For the purposes of calculating the financial correction, the corrections made in regard to the systemic errors should be deducted from the extrapolated financial correction.

In case systemic errors are detected by the AA's audits of operations and those errors are delimited for the whole population (cf. section 2.2 above), this implies that, when extrapolating the random errors found in the sample to the population, the AA should deduct the amount of systemic error from the population, whenever this value is part of the projection formula, as explained in detail in appendix 1 of the guidance on sampling.

ACR is finalized) established for the year N, or on a flat-rate basis, taking into account all the information available to the AA at the time of drafting the audit opinion.

The estimation of the impact of a qualification as "limited" is deemed appropriate when it relates to irregularities (not yet corrected at the time of submission of the ACR to the Commission) corresponding to expenditure above 2% but below 5% of the total expenditure certified in year N. If those irregularities exceed 5% of the total expenditure certified in year N, the corresponding qualification should be estimated as "significant". The same reasoning applies when the exact amount of the irregularities cannot be quantified precisely by the AA and a flat rate is used; this may be the case of system deficiencies.

All errors should be quantified by the AA. In general, all errors found in the context of the random sample used for the audits of operations are to be taken into account for calculation of the TPER, with the exceptions of anomalous errors (cf. section 2.4 above) and the particular cases described in sections 7.1.1 and 7.5 below. Without this quantification, the TPER cannot be considered reliable since it is probably understated by the errors that were not quantified. In this circumstance, the audit opinion should be qualified.

The errors considered in the TPER should relate to findings disclosed in a final audit report, i.e. after the contradictory procedure with the auditee has been concluded. In duly justified cases where such contradictory procedure was not concluded before submission of the ACR, this could constitute a limitation in scope and a qualified opinion may be provided on the basis of the AA's professional judgement. The quantification[15] of the qualification in the audit opinion may be calculated on the basis of the maximum amount of error that the AA considers reasonable on the basis of the information it has available.

The TPER presented in the ACR should be the error rate before any corrections applied by the Member State as a result of the audits of operations carried out by the AA. The AA's audit opinion is based on the TPER and on the corrective measures that may have been applied by the Member State before submission of the ACR, in line with section 5 above[16].

Experience shows that the link between the audit opinion (on the proper functioning of the MCS and the legality and regularity of the expenditure) and the conclusions obtained from the system audits and audits of operations usually correspond to the pattern explained below. The following table is indicative and requires the AA to use its professional judgment, in particular for situations that may not be foreseen below. As set out in section 5 above, the corrective measures may concern financial corrections (aiming at a RER below or equal to 2%) or improvements destined to overcome deficiencies in the MCS (not covered by the financial corrections) or a combination of both.

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[15] See section 7 of the Guidance on ACRs and Opinions.

[16] In the particular case where an irregular expenditure had already been detected and acted upon by the national authorities (but not yet corrected before the sample was drawn), it is possible that the AA decides to exclude that irregularity when projecting sample errors to the population, when certain conditions are met (cf. section 7.1.1. below). The AA should disclose in the ACR, under the section on the audits of operations, whether this situation has occurred, the amount of the expenditure for the particular irregularity and whether it has been corrected.

Audit opinion	AA's assessment on		
	Functioning of MCS **(results of system audits)**	**TPER** **(results from audits of operations)**	**Implementation[17] of the required corrective measures by the Member State**
1-Unqualified	category 1 or 2	and TPER ≤ 2%	Corrections (e.g. errors in the sample) implemented.
2-Qualified (qualifications have a limited impact)	category 2	and/or 2% <TPER≤ 5%	Except if adequate corrective measures (including extrapolated financial corrections) are implemented (unqualified opinion possible).
3- Qualified (qualifications have a significant impact)	category 3	and/or 5% <TPER ≤ 10%	Corrective measures not fully implemented (including if extrapolated financial corrections are implemented but system deficiencies remain).
4-Adverse	category 4	and/or TPER > 10%	Corrective measures not fully implemented (including if extrapolated financial corrections are implemented but system deficiencies remain).

If the AA considers that the MCS is in category 2 and the TPER is below the materiality level of 2%, the audit opinion may be unqualified.

However, if the MCS is classified in category 1 or 2 and/or the TPER is above 2% this indicates that, despite the relatively positive assessment resulting from the systems audits carried out by the AA, the MCS is in practice not sufficiently effective in preventing, detecting and correcting irregularities and recovering amounts unduly paid. A qualified audit opinion is therefore deemed appropriate[18] in this case. However, if the RER is below or equal to 2%, where corrective measures have been implemented by the Member State before the ACR is submitted to the Commission (cf. section 5.2 above), the AA may issue an unqualified opinion.

A qualified opinion should be disclosed when the MCS is in category 3 and/or the TPER is above 2%, except where the RER is below or equal to 2% and the corrective measures

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17 Cf. section 5 of this guidance.

18 The expression "deemed appropriate" implies that the professional judgment of the AA is required in order to draw appropriate conclusions on its work.

(including the ones relating to systems deficiencies) have been implemented before the ACR is finalized. In this case the AA may issue an unqualified opinion.

A TPER above 5% and/or a MCS in category 3 or 4 should lead to a qualified opinion.

A TPER above 10% and/or a MCS in category 4 would normally lead to an adverse opinion.

7. PARTICULAR CASES

7.1. Errors detected by AA in expenditure that was also considered irregular by the MA, IB or CA

7.1.1. Irregularities already detected and acted upon by the IB/MA/CA, but not yet corrected before the sample was drawn by the AA

As stated above, in general all irregularities found are to be taken into account for calculation of the projected error rate and reported in the ACR. This includes the irregularities detected by the AA (during its audits on operations) which have already been detected by another national body (namely the MA the IB or the CA), before the sample was drawn by the AA, but have not been corrected by the Member State before submission of the ACR[19].

However, if there is documentary evidence that the relevant national authorities (MA, IB or CA) have detected the irregularity and were already taking the necessary measures (e.g. launch of the recovery procedure) before the AA's sample was drawn and that the irregular amount has been corrected before submission of the ACR, such irregularity may be excluded when projecting sample errors to the population.

In any case, the treatment of the irregularity concerned should be reported and explained in the ACR in the section concerning audits on operations, since such a correction will impact the Cumulative Residual Risk calculated by the Commission for the purpose of the AAR of the services concerned.

As a general principle, the MA should ensure that its management verifications (administrative verifications or on-the-spot checks) are carried out in a way to prevent, detect and correct irregularities before expenditure is declared to the Commission. However, due to the multi-annuality of the control system, it may happen that on-the-spot checks allow detecting errors not previously spotted during desk checks.

7.1.2. Irregularities detected during controls by the IB or the MA and corrected insufficiently before the sample was drawn by the AA

During an audit an AA identifies that an irregularity was previously detected during a control by another body, but the correction rate applied was lower than the correction rate that the AA considers that the IB or the MA should have been

[19] As stated above, this correction can be done by deducting the irregular expenditure (via a withdrawal or a recovery) from a statement of expenditure submitted to the Commission or by registering the expenditure at stake as a pending recovery in the CA’s accounting system.

applied. In this situation, the difference in the amount resulting from correction at the AA determined rate and the amount actually corrected (at the level of declaration to the Commission before the sample was drawn by the AA) is to be taken into account for calculation of the TPER.

7.1.3. Irregularities relating to expenditure withdrawn after the sample was drawn by the AA

After selecting the sample of operations, the AA may identify irregular expenditure in the operations to be audited that has been withdrawn or "de-certified" by the MS. In terms of the practical arrangements to be adopted by the AA for the on-the-spot audits, two different cases are envisaged:

(1) In case the irregular expenditure "de-certified" concerns all the expenditure of a given operation included in the sample selected by the AA, this body is not required to audit on-the-spot such operation. The sample should not be modified, i.e. the operation at stake should not be replaced by another operation.

(2) In case the irregular expenditure "de-certified" concerns only part of the expenditure of a given operation included in the sample selected by the AA, this body should audit the operation on-the-spot in order to detect if the part not de-certified is free from errors.

In both cases, the irregular expenditure should be taken into account in the error rate.

7.2. Net off with an expenditure "buffer" at project level

It may happen that in year N the beneficiary declares to the MA (or IB), in relation to a given operation, more expenditure than the one that was initially budgeted in year N. This corresponds to an expenditure "buffer". The declaration of eligible expenditure to the Commission is in any event capped to the maximum amount set out in the grant agreement and approved budget for the operation at stake.

This is without prejudice to Article 98 of Regulation (EC) No 1083/2006. Where the Member State decides, under this provision, to apply a financial correction to an individual operation by cancelling all or part of the public contribution (or when the Commission proposes such a financial correction under Articles 99 and 100(4) of the same Regulation), the contribution from the cancelled funds may be reused for other operations than the ones subject to the correction. Article 98(3) specifies that reuse of the cancelled contribution for the operation subject to the correction is not permitted.

One example of netting off with an expenditure buffer at project level is the following. The project's budgeted expenditure is 100 000 EUR and the public co-financing is 40% of expenditure, up to a maximum 40 000 EUR. The beneficiary has declared to the Managing Authority the expenditure of 110 000 EUR and received the maximum grant of 40 000 EUR. The AA audits the 110 000 EUR declared by the beneficiary and identifies ineligible expenditure of 9 000 EUR. In this case, even if ineligible expenditure is found in the total expenditure of the operation audited (including the buffer, which was part of the expenditure audited), there is still enough eligible expenditure to entitle the beneficiary to the maximum public grant[20]. In this case, the AA may consider that there is no error to be reported since there is no impact on the EU reimbursement, since the buffer existed at the time when the AA detected the ineligible expenditure at stake. However, the fact that all expenditure, including the buffer, was considered as eligible by the MA may indicate the need to improve their verifications. In this case, the AA should recommend to these authorities to improve or reinforce their verifications.

Another example is when for the project above, the beneficiary has declared to the MA the expenditure of 110 000 EUR. The AA audits the 110 000 EUR declared by the project and identifies ineligible expenditure of 15 000 EUR. The beneficiary is entitled to a maximum grant of 38 000 EUR (95 000 EUR*40%). The detected error (5 000 €) has an impact on the expenditure declared as eligible to the Commission. In this case, the AA should include that error in the TPER. National authorities may have to issue a recovery order to the beneficiary (for example if the operation is completed) and the maximum grant is reduced accordingly.

7.3. Net off overstatement errors against understatement errors

Considering that the concept of error relates to undue overstatements in the expenditure declared, understatement errors should not be deducted from overstatements in the calculation of the TPER.

7.4. How should fraud and suspected fraud be reported in the ACR and reflected in the error rate?

The ACR should indicate the steps taken in regard to cases of fraud or suspected fraud identified during the audit work or before submission of the ACR.

The ACR should disclose whether the cases of fraud or suspected fraud were communicated to OLAF. If allowed by national rules for on-going investigations, the AA should gather information on the nature of the fraud and assess if this is a systemic issue and, if yes, whether mitigating actions have been taken.

As set out in Article 27(c) of the Regulation (EC) No 1828/2006, *"'suspected fraud' means an irregularity giving rise to the initiation of administrative or judicial proceedings at national level in order to establish the presence of intentional behaviour, in particular fraud, as referred to in Article 1(1)(a) of the Convention drawn up on the basis of Article K.3 of the Treaty on European Union, on the protection of the European Communities' financial interests"*.

In case there are operations that have been included in the random sample but which the AA cannot audit due to retention of supporting documents by judicial authorities (namely due to suspicion of fraud), the following three cases are foreseen:

1) When the AA has evidence to suggest a suspicion of fraud concerning the sampled operation (e.g. report from the police) or when the existence of fraud is confirmed by the competent national judicial authorities, the expenditure at stake is

[20] This would comply with Article 98(3) of Regulation (EC) No 1083/2006 (or Article 96(3) of Regulation (EC) No 1198/2006 for EFF) insofar there is no cancellation of the public contribution for the operation at stake, i.e. the 40 000 EUR would still be financed by public expenditure.

counted as an error (random, systemic or anomalous) and included in the TPER. If after the ACR has been submitted, the AA obtains information leading to the conclusion that the suspicion of fraud was not confirmed, then the AA may revise the TPER and inform the Commission accordingly in the next ACR.

2) When there is insufficient information or evidence available, the AA may replace the sampled operation by another one by applying a random selection to the remaining population, using the same sampling method, if this can be made on time for the submission of the ACR. Otherwise, the AA may consider counting the operation initially sampled with zero error (if no irregularities are detected) and include the respective expenditure in the population for the calculation of the projected error.

3) If the AA has not replaced the sampled operation at stake and if the quantification of the irregularity is only possible after the submission of the ACR for the reference year in question, a revised TPER should be calculated by the AA and transmitted to the Commission as soon as possible. The AA should disclose in the ACR the cases identified by this exceptional situation and its impact to the AA´s opinion.

Obviously, if the AA can audit the operations subject to suspected fraud because the supporting documents are available to the AA, it is up to AA to conclude, on the basis of its own work whether there are irregularities in expenditure declared, without prejudice to the outcome of fraud investigations, if any.

7.5. Should bankruptcies or insolvencies be included in the error rate?

When the AA has included in its sample an operation that is subject to a bankruptcy or insolvency process, with the effect that the operation's objectives or other grant conditions cannot be met (e.g. State aid linked to job creation in the beneficiary company), but there are no particular indications of negligence on the side of the Managing Authority when selecting the operation for co-financing, should the expenditure declared for that operation be included in the TPER?

To reply to this question, it is important to note that Regulation No 539/2010 added a paragraph 5 to Article 57 of Regulation (EC) No 1083/2006: "*Paragraphs 1 to 4 shall not apply to any operation which undergoes a substantial modification as a result of the cessation of the productive activity due to a non-fraudulent bankruptcy*".

In view of this provision, the Commission considers that, in case of cessation of the productive activity due to a non-fraudulent bankruptcy, the Member State will be exempted to investigate the irregularity concerned and to make adequate financial corrections and the Member State and the Commission will not have to take the necessary measures in order to recover the amounts unduly paid.

The corollary of this reasoning is that there is no error to be considered in the TPER in relation to a bankruptcy case when Article 57(5) of Regulation (EC) 1083/2006 is applicable.

An insolvency or bankruptcy case would only constitute an error to be considered in the TPER in two situations:

1) When it relates to fraud established by the competent national judicial authorities, in which case the correction should be the totality of the expenditure affected.

2) When it relates to lack of adequate selection procedure by the Managing Authority (i.e. breach of Article 60(a) of Regulation (EC) No 1083/2006), in which case the error can be quantified at 5%, 10%, 25% or 100% of the expenditure declared for the operation at stake, as follows from the Commission's decision on financial corrections[21].

If one of the two cases above-mentioned is applicable, then the AA should also consider the timing in which the bankruptcy occurred, in the following sense[22]:

1) If the insolvency occurred before the sample was drawn by the AA, and the MA has responded without delay by revoking the grant agreement and starting a recovery procedure[23], this is a situation similar to the one covered by section 7.1.1 above. In this case, the irregularity may be excluded when projecting the random errors to the population.

2) If the insolvency occurred after the sample was drawn by the AA (therefore, the necessary measures are taken by the MA also only after the sample is drawn), the irregularity is to be considered a random error to be included in the projection of random errors.

Of course, the existence of insolvency/bankruptcy does not prejudice the need for the AA to seek assurance that the expenditure for the operation at stake is legal and regular in relation to the remaining applicable provisions.

7.6. What approach should the AA adopt in case supporting documentation of the sampled operations is lost or damaged due to "force majeure" (e.g. natural disasters)?

As a result of the natural disasters in Central Europe, some AAs asked what should their approach be when the supporting documentation held at the level of beneficiaries is lost or damaged due these natural events (loss of sufficient audit trail).

The AA should request the concerned national authorities to reconstruct the audit trail using documentation kept in electronic format and other sources (e.g. contractors,suppliers, banks). However, this reconstitution of the audit trail has to be done within reasonable limits (including time and administrative efforts), as it may

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21 Commission Decision of 19.10.2011 on the approval of guidelines on the principles, criteria and indicative scales to be applied in respect of financial corrections made by the Commission under Articles 99 and 100 of Council Regulation (EC) N° 1083/2006 of 11 July 2006.

A quantification at 100% would be justified if the MA has not checked whether the beneficiary's financial situation was satisfactory (i.e. it would not lead to bankruptcy) and this was a condition to be checked before selecting the operation.

22 As follows from section 8.1.1 above.

23 The action from the MA may also depend from national rules and procedures related to the insolvency and bankruptcy processes. The AA should use professional judgment when analysing the timing of the MA reaction to the concrete situation of bankruptcy or insolvency in hand.

be that such reconstitution causes undue or unjustifiable hardship for the audited entity based on facts and circumstances. Professional judgment will be required in reaching this conclusion[24].

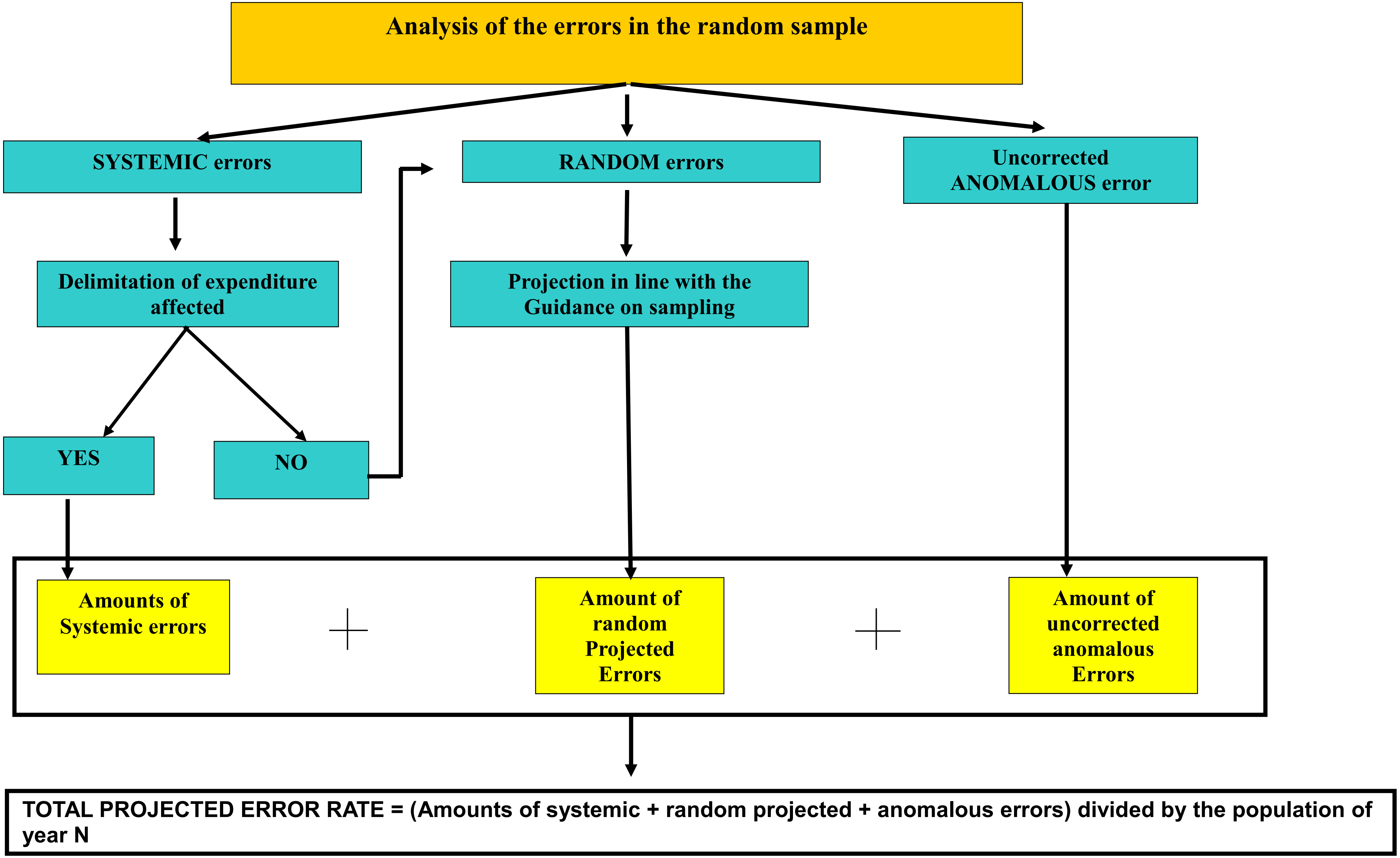
It may also be that, even if the audit trail is incomplete, the missing documentation is not crucial to determine whether the expenditure is eligible. In this case, the AA should disclose a scope limitation if the operation at stake is audited.

For the operations where indeed the audit trail cannot be reconstituted (at least partially) due to "force majeure" (caused for example by natural disasters) or the costs of that reconstitution are greater than the benefit of ensuring the audit trail, the MA should obtain confirmation (e.g. a letter from the beneficiary or the IB) that this was the case and all the attempts to recover the documentation were unsuccessful. This information should be acceptable to national audit authorities. With this confirmation, the MA could then conclude that Article 19 of Regulation (EC) No 1828/2006 (on availability of documents) cannot be complied with for the operations at stake, due to a "force majeure" event.

The MA should have a list of all the operations affected, which should then be excluded from the population from which the AA sample is drawn, if the "force majeure" event occurred beforehand. If the AA has already selected such operations for audit on the spot and no alternative procedures are feasible to verify the eligibility of the expenditure, then the replacement by other operations is envisaged.

[24] See pages 6 to 10 of U.S. Government Accountability Office (GAO) on " Government Auditing Standards: Temporary Exemptions and Guidance in Response to Hurricanes Katrina and Rita" (http://www.gao.gov/govaud/hurricanedocument.pdf).

ANNEX 1 – TOTAL PROJECTED ERROR RATE



Annex 2- Table for declared expenditure and sample audits

Fund	Reference (CCI no)	Programme	Expenditure declared in reference year[25]	Expenditure in reference year audited for the random sample		Amount and percentage (error rate) of irregular expenditure in random sample[26]		Total projected error rate[27]	Other expenditure audited[28]	Amount of irregular expenditure in other expenditure sample	Total expenditure declared cumulatively	Total expenditure audited cumulatively[29] as a percentage of total expenditure declared cumulatively
				Amount[30]	%[31]	Amount	%	%				

[25] This column should refer to the population from which the random sample was drawn, i.e. total amount of eligible expenditure declared to the Commission for year N, less negative sampling units if any. For example, if 23 million € have been declared as eligible expenditure and this includes 3 million € of negative sampling units, then the amount to be disclosed in the column A is 26 million € since this corresponds to the population of positive amounts. Where applicable, explanations shall be provided in the ACR, under the section on audits of operations.

[26] Where the random sample covers more than one Fund or programme, the information on the amount and percentage (error rate) of irregular expenditure is provided for the whole sample and cannot be provided on programme or fund level. Where stratification is used, further information by stratum should be provided in the ACR, under the section on audits of operations.

[27] The concept of total projected error rate is explained in section 2.6 of this guidance.

[28] Where applicable, "other expenditure audited" should refer to expenditure audited in the context of a complementary sample for the reference year.

[29] Includes both expenditure audited for the random sample and the other expenditure audited.

[30] Amount of expenditure audited (in case sub-sampling is applied, only the amount of the expenditure items effectively audited should be included in this column).

[31] Percentage of expenditure audited in relation to expenditure declared to the Commission in the reference year.

ANNEX 3 – CORRELATION TABLE BETWEEN THE SECTIONS OF THE PREVIOUS GUIDANCE AND THE UPDATE GUIDANCE ON TREATMENT OF ERRORS

Sections of the COCOF 11-0041-01-EN of 07/12/2011 and EFFC/87/2012 of 09/11/2012	**Corresponding section in the updated guidance on treatment of errors**
1. Introduction	1. Introduction
2. Evaluation of errors	2. Evaluation of errors
2.1 Approach set out in previous guidance from the Commission	[Replaced by new section "2.1. Overview of types of error".]
2.2 Systemic errors	2.2 Systemic errors
2.3 Random errors	2.3 Random errors
2.4 Anomalous errors	2.4 Anomalous errors
2.5 Errors relating to unfinished contradictory procedure	[Included in section 6.]
2.6 Total projected error rate	2.5 Total projected error rate
3. Disclosure of errors in ACR via SFC2007	3. Disclosure of errors in ACR via SFC2007
4. Inadequate audit opinions	4. Inadequate audit opinions
5. Corrective measures	5. Corrective measures
5.1 Concept of corrected error for determining the audit opinion	5.1 Concept of corrected error for determining the audit opinion
5.2 Corrective measures as subsequent events	5.2 Corrective measures as subsequent events
5.3 Option 1: extrapolated financial correction	5.4 Extrapolated financial correction
5.4 Option 2: Analysis and correction of each type of error	5.3 Correction of each type of error
5.5 Net off with an expenditure "buffer"	7.2 Net off with an expenditure "buffer"
[New section of the updated guidance on treatment of errors.]	6. TPER and the assurance on the effective functioning of the MCS
6. Implications for sampling resulting from high error rate	[Section deleted since it is covered by sections 8.1, 5.11 and 8.2.2 of the Guidance on sampling, updated in 2013.]

Sections of the COCOF 11-0041-01-EN of 07/12/2011 and EFFC/87/2012 of 09/11/2012	**Corresponding section in the updated guidance on treatment of errors**
7. Most Likely Error and Upper Error Limit	Idem.]
8. Particular cases	7. Particular cases
8.1 Errors detected by AA in expenditure that was also considered irregular by the Managing Authority, Intermediate Body or Certifying Authority	7.1 Errors detected by AA in expenditure that was also considered irregular by the Managing Authority, Intermediate Body or Certifying Authority
8.1.1 Irregularities already detected and acted upon by the IB/MA/CA, but not yet corrected before the sample was drawn by AA	7.1.1 Irregularities already detected and acted upon by the IB/MA/CA, but not yet corrected before the sample was drawn by AA
8.1.2 Irregularities detected during controls by IB/MA and corrected insufficiently before the sample was drawn by the AA	7.1.2 Irregularities detected during controls by IB/MA and corrected insufficiently before the sample was drawn by the AA
8.1.3 Irregularities relating to expenditure "de-certified" after the sample was drawn by the AA	7.1.3 Irregularities relating to expenditure "de-certified" after the sample was drawn by the AA
8.2 Net off overstatement errors against understatement errors to arrive at an overall most likely error	7.3 Net off overstatement errors against understatement errors to arrive at an overall most likely error
[New section of the updated guidance on treatment of errors.]	7.4 How should fraud and suspected fraud be reported in the ACR and reflected in the error rate?
[New section of the updated guidance on treatment of errors.]	7.5 Should bankruptcies/insolvencies be included in the error rate?

Sections of the COCOF 11-0041-01-EN of 07/12/2011 and EFFC/87/2012 of 09/11/2012	Corresponding section in the updated guidance on treatment of errors
[New section of the updated guidance on treatment of errors.]	7.6. What approach should the AA adopt in case supporting documentation of the sampled operations is lost or damaged due to "force majeure" (e.g. natural disasters)?
Annex 1 – Total projected error rate	Annex 1 – Total projected error rate
Annex 2 – Table for declared expenditure and sample audits	Annex 2 – Table for declared expenditure and sample audits