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**REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE  
EUROPEAN COURT OF AUDITORS**

**"TAKING STOCK OF "SINGLE AUDIT" AND THE COMMISSION'S RELIANCE  
ON THE WORK OF NATIONAL AUDIT AUTHORITIES IN COHESION"**

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#### **EXECUTIVE SUMMARY**

II. The Commission shares the Court's conclusion and also considers that a better system for auditing Cohesion spending for the 2007-2013 programming period is in place. The improved regulatory framework has put in place an audit authority in charge of testing legality and regularity of expenditure through system audits and audits of representative samples of operations and of reporting its conclusions each year to the Commission through an audit opinion and a control report.

III. The Commission underlines that through the regulatory framework for 2007-2013, the level of assurance it can obtain has increased significantly, in particular by allowing assessing the assurance for each operational programme each year as from the start of implementation. Therefore the cost of controls should be assessed from a cost-efficiency perspective.

The Commission notes that eligible costs under technical assistance at the disposal of Member States (article 46 of Regulation 1083/2006) include audits and controls together with management, monitoring and evaluation costs. Available technical assistance monies are in most cases up to 4% of funding for each programme.

IV. The Commission welcomes the acknowledgement of its work and significant efforts, in close cooperation with audit authorities, to ensure better consistency in their approaches and working methods through guidance, targeted training and re-performance work that contribute to capacity building.

V. The Commission's assurance is based on the assessment of key elements of the management and control systems based on all available audit results

The Commission has in place a robust and thorough process to analyse the error rates reported by Member States. When it cannot validate or recalculate error rates, the Commission estimate the level of risk by using flat rate amounts (5-10-25-100%) instead of unreliable reported error rates for its assurance process. The use of additional tools, such as the cumulative residual risk, allowed Commission services to consider additional reservations in the annual activity reports compared to previous years.

The Commission always aims at ensuring that the reporting made to the Discharge Authority gives a fair and reliable picture of the estimated risk affecting the EU budget for each Member State, taking also account of the multiannual corrective capacity. The Commission services provide all available information in full transparency in their annual activity reports.

VI. The Commission can only notify article 73 to a programme once a positive assessment of all elements of the management and control system is reached. This assessment of the audit authority's work necessitates that sufficient on-the-spot re-performance audit work is carried out in accordance with international audit standards. The Commission considers it follows a prudent and robust approach to grant the 'single audit' status to some programmes so far.

VII.

First indent:

The Commission has a thorough verification process in place, including on-the-spot fact-finding missions, in order to ensure the accuracy and reliability of the error rates reported by national audit

authorities. It alternatively uses flat rates when it considers error rates as unreliable. This process is complemented by an exhaustive Commission audit enquiry since 2009 whereby 269 audit missions allowed reviewing the work of audit authorities, including through re-performance, covering more than 90% of Funds allocations. The Commission also carries risk-oriented audits to verify the accuracy of reported financial corrections.

Second indent:

The Commission considers that the single audit status was granted based on robust, consistent and transparent criteria. It furthermore considers that by the end of 2013 all requirements are fulfilled for these programmes.

The Commission will continue to apply a robust approach, further clarified with the implementation of its roadmap on article 73, up-dated in September 2013.

Third indent:

The Commission considers this recommendation is implemented through the updated roadmap and the audit enquiry on monitoring article 73 adopted in September 2013.

Following the granting of the first batch of article 73 decisions in the first half of 2012 and based on pilot missions, the Commission services developed an audit methodology to carry out monitoring missions, which include re-performance work and working paper reviews, in line with International Standards on Auditing.

Fourth indent:

The Commission has introduced in its proposal for Common Provisions Regulation for 2014-2020 and the legislator has agreed on the possibility for net financial corrections in the event of serious irregularities identified after the submission of the annual accounts and not previously detected and/or reported by the audit authority.

The Commission intends to propose in the secondary legislation that flat rate corrections can be increased for repeated breaches involving the same deficiencies, where the Member State has failed to take adequate corrective measures for that part of the system that was affected and subject to a previous correction.

Fifth indent:

The Commission is taking measures to ensure improved secondary legislation and timely and complete guidance within a stable methodological framework for the work of the audit authorities, building on the accumulated experience of the 2007-2013 programming period.

The Commission will further clarify some aspects of the existing guidance through written clarification by the end of 2013.

Furthermore, according to the regulation for the 2014-20 programming period, the Commission is empowered to adopt, by means of implementing and delegated acts, binding models and/or requirements for the audit work of audit authorities that should build up on the experience and good practices of the 2007-2013 programming period.

Sixth indent:

The Commission considers that this recommendation is already implemented in the 2011 Impact Assessment (see footnote 71). It further notes, under shared management and in respect of the principle of subsidiarity, the decision to allocate technical assistance to the different cost categories is taken by the Member States.

Furthermore, in the 2014-2020 regulation, the Commission reinforces its cost-efficiency approach for Cohesion. As a consequence, the newly designed arrangements for the implementation of the funds, including in relation to controls, "(...) *shall respect the principle of proportionality having regard to the level of support allocated and shall take into account the overall aim of reducing administrative burden for bodies involved in the management and control of the programmes*".

## **INTRODUCTION**

7. In 2012 DG Regional and Urban Policy and DG Employment, Social Affairs and inclusion (hereafter "DG Employment") received respectively 680 and 522 system audit reports from the audit authorities. The Commission analyses the results of all audit reports and uses them in its supervisory role during the year initiating interruption/pre-suspension procedures when needed and in its assurance process.

9. In order to be able to rely on the audit results and error rates reported by the audit authorities, and in line with international auditing standards, DG Regional and Urban Policy and DG Employment have so far carried out an extensive review and re-performance of the audit authorities' work, which is and continues to be the main enquiry for DG Regional and Urban Policy and DG Employment.

When deficiencies are identified in the work of audit authorities, depending on the seriousness of the required improvements extensive action plans are put in place accompanied by interruption/suspension procedures where necessary to correct these deficiencies and bring the audit work up to standard. This re-performance of the audit authorities' work also allowed an extensive capacity building by sharing audit checklists, raising awareness on risky areas and identifying areas and solutions for improvement of the national audit work.

The methodology for the assurance process and for determining reservations is described in annex 4 of the annual activity reports of DG Regional and Urban Policy and DG Employment.

### **Box 2 - Use of error rates reported by national Audit Authorities in the Commission's assurance process**

The analysis of the error rates reported by year end by the audit authorities needs to be done for all 434 ERDF/CF and ESF programmes in good time for the annual activity report, a first version of which has to be ready by end February (and adjusted until the date of signature on 31 March). The Commission underlines that the objective is to indicate estimates of error rates within a statistically valid range, or in case of non-statistical sample foreseen in the regulation useful indicators to estimate the risk for the payments to the programmes in the year under assessment.

The Commission also uses flat rates to estimate that risk when it considers reported error rates to be unreliable.

The Commission refers in the annual activity reports to the average risk rate for all programmes of each Member State, based on the validated error rates, to quantify the amounts included in interim payments made in the year under assessment and at risk. Due to the decalage foreseen in the regulation to allow time for the audit authorities to carry out their audits, this estimate of the risk in payments made in year N is based on the validated error rate reported for expenditure declared in year N-1, being the best estimate available at the time of signing the annual activity report. Since 2012 DG Regional and Urban Policy and DG Employment also present in their annual activity report the average cumulative (multi annual) residual risk per Member State, taking into account all corrections reported by the Member States as deducted from all payments claims up to the end of year N.

10. According to the Commission's assurance process methodology, a programme with a validated error rate above 5% would be put under reservation already at step 1, unless the necessary financial

correction and action plan have been implemented before the signature of the annual activity report (see also paragraph 40).

11. The Commission agrees that the processes to establish an overall error rate by the Court and the Commission's assessment of the risk to its payments in the year differ for the reasons quoted by the Court and due to the nature of the different institutional roles. However the objective of this process is essentially the same, i.e. assessment of the risk to the EU budget in a particular year.

The Commission takes into account all these differences in its assessment, in particular timing differences in quantification of public procurement errors. This is evidenced by the fact that, as shown in the last three years in a row for DG Employment and two years in a row for DG Regional and Urban Policy, the result of this assessment is in line with the error rates calculated by the Court.

The Commission's assessment also takes account of the multiannual character of cohesion policy and of the corrective capacity for each programme, through the calculation of a cumulative residual risk.

Some of the differences quoted by the Court will be removed in the regulatory framework for the 2014-2020 programming period further enabling the full implementation of the single audit principle.

12. The Commission welcomed the principles laid down in the Court's Opinion 2/2004, which have been an important element in developing the 2007-2013 regulations concerning the set-up of the management and control systems.

15. The Commission welcomes the conclusion of the Court. The Commission has designed its system generally in line with the "Single Audit" principles set out by the Court (see also paragraph 80).

The main advantage of applying article 73 for the Commission lies in the possibility to focus its limited audit resources to higher risk programmes and authorities rather than reduce its control work overall. In addition, single auditing still requires monitoring of the work of the audit authority and thus remains a crucial issue.

16. The conditions to grant article 73 relate both to the reliability of the work of the audit authority and to the fact that the management and control systems function well. The Commission must therefore carry out considerable detailed audit work in accordance with international standards on auditing, before it can grant an article 73 status. This also explains why the article 73 status can only be granted after some years of programme implementation.

It also means that where the management and control system of a programme, independently from the audit authority, is still not sufficiently robust, no article 73 status can be granted to the programme even if the Commission is satisfied based on its audit work with the functioning of the audit authority.

Common reply to paragraphs 17, 18 and 19

Each decision to grant an article 73 is specific for a programme under the responsibility of the respective directorate general of the Commission.

The conditions to grant the article 73 status to a programme have been set out in a "roadmap towards the implementation of Article 73" discussed with the Audit Authorities in 2009 and 2010 and finalised on 13 October 2010. The audit authorities have thus been fully associated and informed on the criteria and benefits of having an article 73 status for a particular programme.

The initial roadmap has been formally updated in September 2013, following the first decisions on granting Article 73 status in early 2012. The update relates to the clarification of the conditions to

grant Article 73 as well as to the corrective measures to be taken if one or more of the conditions are (temporarily) no longer fulfilled. In addition a specific audit enquiry setting the methodology and steps to monitor the implementation of article 73 has been jointly designed and is being implemented by all concerned Commission services under their inter-service level agreement.

As set out in the updated roadmap and in this audit enquiry, the Commission will take the decision to resume its own on-the-spot audits when it is no longer justified maintaining reliance on the work of the audit authorities. This may result from the fact that material deficiencies have not been reported and taken into account in the annual audit opinion for a given year and a request by the Commission to implement action plans/corrective measures has not been adequately followed up by the audit authority.

## **OBSERVATIONS**

27. As indicated in the executive summary of DG Regional and Urban Policy's 2012 annual activity report, the decrease in the number of reservations is mainly due to the corrective actions taken in the Member States and the implementation of financial corrections by the Commission (see 2012 annual activity report for DG Regional and Urban Policy, pages 46 to 49). The strict policy followed by DG Regional and Urban Policy on warnings, interruptions, suspensions and financial corrections has worked as an incentive for the concerned Member States to improve the weak management and control systems.

29. In addition to the two indicators mentioned by the Court, the Commission bases its assurance on an in-depth process and various steps, taking into account many other national and Union audit results and information beyond simply the two indicators quoted by the Court.

The result of this process and analysis is described in detail in the respective annual activity reports of DG Regional and Urban Policy 2012 and DG Employment (see page 35 and annex 9 and page 37 and annex 8 of respectively DG Regional and Urban Policy and DG Employment 2012 annual activity reports).

Common reply for paragraph 30 and box 4

The Commission acknowledges the fundamental role played by the audit authorities and the importance to ensure the accuracy and reliability of the information reported in the Annual Control Reports.

For this reason, the Commission carried out an extensive audit work done through 269 audit missions over the years in order to assess the effectiveness of the audit authorities covering 96% and 99% of the respective allocations of ERDF/CF and ESF.

Between 2009-2013, the Commission re-performance audit work on audit authorities showed that:

- Out of 47 audit authorities audited, DG Regional and Urban Policy concluded that, at this stage, 38 audit authorities were reliable.
- Out of 84 audit authorities, DG Employment concluded that 78 were reliable.

The Commission thus considers that it has obtained reasonable assurance that audit authorities covering around 90% of the funds allocations comply with Article 62 of (EC) Regulation and provides a reliable basis for the Commission's assurance and for applying the single audit concept.

Those results are complemented by the Court's examinations of audit authorities over the last three years.

In particular, when the Commission has doubts as to the accuracy and reliability of the error rates reported by national audit authorities, it discloses in its annual activity report the reported error rates

which are recalculated when sufficient information is available, or which are replaced by flat rates when they are considered unreliable.

First indent:

In two cases, the Commission notes that there were some weaknesses in the sampling approach, but considers that there was no significant impact.

In three cases, the Commission had found similar weaknesses as the ones reported by the Court and has taken appropriate actions. In one case reported by the Court in 2013, the follow-up is on going.

Second indent:

In six cases, the Commission considers that the audit authorities are effective with respect to audits on operations. For the remaining six cases, the Commission followed up the weaknesses detected by the Court.

Third indent:

In two cases, the Commission agrees that there were some weaknesses in the audit authority procedures and the Commission ensured the follow-up. However the Commission's assessment of the reported error rates and annual control reports led to appropriate conclusions, considering also the additional audit work performed by the audit authority at the request of the Commission where necessary.

In the remaining three cases, the Commission had found similar weaknesses as the ones reported by the Court and took appropriate actions, including the interruption of payments until remedial actions were implemented by the concerned audit authority.

As a result of the actions taken to remedy weaknesses identified, the Commission has as of today reasonable assurance that all but one ERDF/CF and ESF audit authorities examined by the Court are effective. For the remaining audit authority identified by the Commission and the Court as non effective, remedial actions are still on-going for some ERDF/CF and ESF programmes.

For the five audit authorities which under-reported error rates for ERDF/CF programmes during either 2010, 2011 or 2012, the situation is as follows:

- in one case, the under-reporting had no impact on the Commission's assessment because the audit authority's opinion was qualified and a reservation has been made in the 2010 annual activity report
- the cumulative residual risk was below 2% in another case,
- the Commission considered the reported error rates as unreliable and used flat rates for the purpose of its assurance process in three cases; it expressed reservations in the respective annual activity reports and interrupted payments to the corresponding programmes.

Moreover the Commission is working pro-actively with these audit authorities in order to improve the reliability of their reported error rates.

31. The Commission interrupts payments as soon as it has evidence to suggest problems including in the functioning of an audit authority. Furthermore, substantiated evidence of shortcomings in the functioning of an audit authority following a Commission audit always leads to the initiation of a suspension procedure until such time that the necessary corrective measures have been implemented by the Member State.

The corrective measures are further strengthened in the draft regulations for the 2014-2020 programming period, which foresee net financial corrections in the event of serious irregularities identified after the submission of the annual accounts and not previously detected/reported by the programme audit authority.

Common reply to paragraphs 32 & 33:

The Commission has developed a robust methodology to verify and validate the error rates reported by the audit authorities. The Commission's conclusions of the desk review with regard to the accuracy and reliability of the error rates reported in the annual control reports are also based on the assurance obtained from the extensive audit enquiry on the review of the work of audit authorities (see replies to paragraph 9).

Through this desk review process, the Commission clarifies any doubt that may arise as to the accuracy and/or reliability of the reported error rates. If needed, it obtains detailed audit results supporting the calculation of the error rate in writing or during on-the-spot fact-finding missions.

In 2013 the Commission services carried out 12 on-the-spot fact-finding missions covering 64 ERDF/CF programmes in 11 Member States and 15 missions covering 23 ESF programmes in 10 Member States. Based on all collected information, the Commission adjusted the reported error rates for 21% and 15% of the of the ERDF/CF and ESF programmes respectively, and considered 11% of the reported error rates for all programmes as unreliable and therefore replaced them by flat rates.

Furthermore, for the two ESF OP's out of the 51 the Commission wishes to underline that the Court, in paragraph 6.34 of the Court's 2012 Annual Report states that the shortcomings in the error rates reported by the Audit Authorities "*do not put into question the number and impact of the reservations formulated by DG Employment in 2012*". For another 44 ERDF/CF programmes the Commission notes that the slight discrepancies reported by the Court did not put into question the number and impact of the reservations formulated by DG Regional and Urban Policy in 2012.

See also replies to paragraphs 34 and 35.

34. The Commission considers that the fact that for 3 years in a row the Commission's own estimated error rate as disclosed in DG Employment's annual activity report is in line with the Court's most likely error rate confirms the validity and reliability of its approach.

For 2011 and 2012, DG Employment's estimated error rates as disclosed in its annual activity report were within a range of 2.0% to 2.5% (see page 43 of the 2011 annual activity report) and 2.3% to 3.2% (see page 37 of the 2012 annual activity report), respectively. The Court's error rates for those years were 2.2% and 3.2%, respectively. Hence the Commission considers that the error rate used by DG Employment for its 2010 annual activity report, which corresponds to the results obtained through the Court's Statement of Assurance exercise, are reliable.

For ERDF/CF programmes, the Court also confirms in its 2012 Annual report that DG Regional and Urban Policy's estimate of amounts at risk for 2012, based on error rates reported by audit authorities in relation to 2011 expenditure and this is in line with the assessment of the Court (paragraph 5.55 of the Court's 2012 annual report).

First indent:

The Commission notes that the 51 programmes quoted by the Court correspond to the work of nine audit authorities out of the total of 112 audit authorities in charge of ERDF, ESF and Cohesion Fund. It notes that the technical issue raised in the case of 31 programmes grouped in a single sample does not modify the audit authority's and the Commission's assessments.

In the remaining cases, the Commission considers that sufficient information was available to conclude adequately on the error rates reported by the audit authorities.

See also Commission reply to paragraph 32.

Second indent:

The Commission welcomes the fact that the Court has come to the same conclusions for all but five out of the 138 cases reviewed. Regarding these five cases that concern two audit authorities, the Commission confirms its assessment as reported in the 2012 annual activity report after an in-depth analysis of explanations provided by the concerned audit authorities and that there was no reason for a reservation. For four of these programmes regrouped in a single sample, the error was corrected in 2012 and therefore the Commission considers that it did not have to be included in the calculation of the projected error rate. For the fifth programme, the Commission considers that taking into account the part of the expenditure that was excluded from the population to be audited would have had a very limited impact on the error rate.

See also Commission's reply to paragraphs 5.52, 4th indent, and 5.57 of the Court's 2012 annual report.

The Commission therefore considers that it has correctly implemented its supervisory role on the error rates reported by the audit authorities.

35. According to the method used for the 2010 annual activity report, the validated error rates were one of the elements for DG Regional and Urban Policy for its final assessment of the programmes. They were not used for the estimate of the minimum and maximum payments at risk, that was based on the methodology used in previous years. As explicitly indicated in its 2010 annual activity report (page 69), DG Regional and Urban Policy estimated the amount at risk between 0,8% and 1,7% of its 2010 payments and considered that "the reported error rates by the national audit authorities which relate to 2009 declared expenditure have to be interpreted with caution when assessing the functioning of the systems in 2010"(page 31). All reported error rates were assessed and validated by DG Regional and Urban Policy, including upwards or using flat rate in more than half of the cases, in 2011 and subsequent years. In some cases reliable revised error rates have been communicated by audit authorities in 2011 or 2012.

Since 2011 onwards, DG Regional and Urban Policy revised its methodology allowing a more precise estimate of the amount at risk, based on error rates reported by audit authorities and validated by the Commission services. At the same time, DG Regional and Urban Policy introduced the calculation of a cumulative residual risk, taking into account financial corrections implemented by Member States. For this calculation, DG Regional and Urban Policy thus uses validated error rates for all years since the start of the programming period, including error rates subsequently revised by audit authorities, error rates it could recalculate and flat rates. Therefore the limitations expressed on the error rates at the time of their reporting in 2010 have no impact on the calculation by the Commission of the cumulative residual risk in 2012. The Court confirmed in its 2012 Annual report that DG Regional and Urban Policy's estimate of amounts at risk for 2012 is in line with the assessment of the Court (paragraph 5.55 of the Court's 2012 annual report).

Regarding the Directorate-General for Employment and Social affairs, the Commission refers to its reply to paragraph 34.

36. The Commission has actively promoted the use of statistical sampling in 2012/2013 through its updated sampling guidance of April 2013, even in the case of small populations of operations, so as to obtain representative results in an increasing number of programmes.

Moreover, it should be noted that the error rate can also be representative in case a formal approach to non- statistical sampling is used, or when the sample audited ensures a high coverage of the expenditure.

However, non-statistical samples for small populations of operations are in line with the regulation and provide the best available indication of the overall risk for the concerned programmes. In such cases, the Commission also takes into account the characteristics of the population and the audit

coverage. The Commission has to use these indicators for the purpose of its assurance process and for the calculation of the cumulative residual risk.

In any case, where the Commission considers the reported error rate as unreliable, it uses flat rates.

37. The Commission agrees with the Court that accounting for financial corrections is a complex task given the timing differences between the Member States' reporting and the Commission's annual activity report deadlines and the various actors involved in their implementation. In order to reflect the multi-annual character of programmes implementation, including of financial corrections, the Commission calculates a cumulative residual risk that is an indicator of how the corrective capacity of the programme is progressing year after year. The Commission aims at ensuring a residual error rate below the materiality threshold at the end of the programming period, by taking into account all financial corrections incurred during the life of a programme.

38. The Commission has to work with the data provided by the Member States by end March each year under the regulatory requirements and which are available under the multi-annual set-up for cohesion policy.

First indent:

The Commission needs to calculate the cumulative residual risk as at the end of the year under assessment in the annual activity report. The cumulative residual risk is an indicator of the corrective capacity of the programme over several years, taking into account the information available at the time of its calculation, both in terms of risk and of financial corrections made.

At the time of the annual activity report, the Commission has at its disposal the Member State's reporting on financial corrections submitted the previous year and data reported for the current year for some programmes. This information can be reviewed by the Commission since most corrections are initiated at the request of the Commission itself.

Furthermore, the Commission has conducted specific risk-based audit work over the last 3 years covering 68 operational programmes in order to ensure that the corrections reported by the Member States are effectively implemented and, in case of doubts or insufficient evidence, deducts the amounts concerned from the cumulative financial corrections taken into account for the purposes of the calculation of the residual error rate.

Second indent:

As indicated in the guidance on treatment of errors disclosed in the annual control report (COCOF\_11-0041-01-EN of 7 December 2011), audit authorities have to project the error rate based on all audit findings and should not take into account financial corrections carried out as a result of their audits for calculating the projected error rates. When formulating their audit opinion, they can take into account subsequent events in the sense of financial corrections taken since the end of their audits. If these corrections are sufficient to mitigate the projected error rate, the audit authority may decide to report an unqualified opinion, but still has to report the projected error rate as calculated.

The Commission will remind the audit authorities about this rule.

Third indent:

Pending recoveries are based on recovery orders issued by the Member State, and to be executed. They are requested by the regulation and it is legitimate to take these corrective actions into account.

Fourth indent:

In accordance with the regulation, Member States have to report any withdrawal included in a payment claim of the previous year. As clarified in the guidance note [footnote: ref. COCOF 10/0002/02 dated 17/03/2010], withdrawals are definitive and cannot be re-instated in subsequent payment claims, except if the irregular amounts were later found to be regular and eligible. In such cases the certifying authority should correct its reporting. The Commission will remind the certifying authorities about this rule.

39. Since the 2011 annual activity reports released in March 2012, any potential instances of negative residual error rates are adjusted to a minimum of 0 as part of the procedures put in place by the Commission to avoid under-estimating the calculation of an overall cumulative residual risk.

The cumulative residual risk reflects the overall corrective capacity of a programme, taking into account the best estimate of the risk, the validated error rate, and information on all corrections carried out, independently from the source of the finding (managing, certifying or audit authority). Therefore, in extreme cases, a cumulative residual risk at zero shows that overall corrections reported and linked to expenditure previously included in payment claims to the Commission were higher than the estimated cumulative risk for the programme, at the time of the calculation.

40. Reservations are mainly based on the assessment of the functioning of the management and control system and the projected error rate, The cumulative residual risk is a second filter to decide on the need for additional reservations. In particular, but not exclusively, in case of a validated error rate between 2% and 5%, it allows deciding if additional reservations should be made. It is certainly not the main source of reservations in the annual activity report, but a complementary one.

This approach was followed for 65 ERDF/CF programmes out of the 67 quoted by the Court. For the remaining two programmes, as indicated by the Court in annex III to its report, exceptions in line with the annual activity report methodology were made and disclosed in the annual activity report since all necessary financial corrections had been implemented in time for the assurance process (cf. DG Regional and Urban Policy 2012 annual activity report, page 35) .

For the 4 ESF OPs with the "projected error rates" above 5%, the necessary financial corrections had already been implemented by the time DG EMPL 2012 Annual Activity Report was issued. Hence, the cumulative error rates calculated for those OP were below 2%. According to the Commission's standing instruction for the 2012 Annual Activity Report, a (quantified reservation) is required only if the cumulative financial risk is above 2%. Moreover, for the 4 programmes concerned, the appropriate action plans were in place in order to prevent these issues from re-occurring.

Moreover, the Commission notes that in paragraph 6.34 of its 2012 Annual Report the Court states that the shortcomings identified in the error rates reported by the Audit Authorities "*do not put into question the number and impact of the reservations formulated by DG EMPL in 2012*".

43. There are two processes which should be clearly differentiated: the formal reliance on the audit authority's work under the conditions imposed by article 73 of the regulation on the one hand, and the fact that the Commission may for the annual assurance process, following its in-depth assessment of the annual control report and taking into account its on-the-spot re-performance work, validate and therefore rely on the reported audit results on the other hand.

The figures reported by the Court reflect the prudent approach followed by the Commission, as mentioned in paragraph 47, and the double condition to rely not only on the audit authority's work and reported error rates but also that all elements of the management and control system for the concerned programme are fully effective (see also reply to paragraph 16).

In addition, the fulfilment of the conditions does not trigger automatically a decision by the Commission to grant Article 73. The Commission uses professional judgement in order to weigh up

all other relevant factors, including, among others, the materiality and criticality of each OP for the Fund as a whole.

Common reply to paragraphs 44 to 46

The Commission could only notify article 73 once sufficient audit work had been carried out in accordance with international audit standards and a positive assessment of the audit authority could be reached.

In addition, even if decisions to grant article 73 were taken in the sixth year of the 2007-2013 period, the implementation of the programmes on the ground runs until 2015, and closure is up to 2017. Furthermore, the implementation of the single audit may play a role for the set-up of the management and control systems for the next programming period and the concept will be maintained and will have a positive impact up to 2023.

The 2010 roadmap was prudently indicating that "a first group of audit authorities could be in a position to benefit or may already benefit from the single audit principle for some programmes/systems and the Commission will principally rely on the opinion of the Audit Authority ". The Commission therefore could not pre-empt a precise timeline before having carried out its review. Indeed, the conditions foreseen in the regulation, as well as audit standards, require that the Commission obtains robust audit results after adversarial procedures before it can decide to implement article 73 to a specific programme. This was only possible after in-depth on-the-spot re-performance work by the Commission under its audit enquiry "Review of the work of audit authorities", carried out as from 2009.

The Commission thus adopted a prudent approach since the first article 73 status were only granted after having received the 2010 and 2011 annual control reports, which were the first ones to report error rates. In the same period, the Commission provided guidance on the elaboration of those reports, the treatment of errors, sampling, etc. in order to ensure reliability and consistency of the information received.

See also reply to paragraph 30.

47. The Commission aims at obtaining "*reasonable assurance that the management and control systems function effectively*" through the assessment of detailed key requirements and functions for each programme. This assessment is based on a synthesis of all audit results by the Commission and the Member State and goes beyond the indication provided by the sole cumulative residual risk indicator. The Commission has formally updated its roadmap in September 2013, including by further clarifying the criteria it follows to grant article 73: acceptance of the audit strategy and compliance assessment; reasonable assurance that the management and control system function effectively and bear limited risks; reasonable assurance that the audit authority works well and that only some or minor improvements are needed, taking account of the Commission's cumulative audit knowledge and experience with this audit authority. It also considers the Court's audit results.

48. Based on its own assessment, the Commission considers that the requirements are in place at the end of 2013 for all 61 programmes. In its assessment, the Commission bases itself on the results of the extensive audit enquiries started in 2009 to effectively verify the reliability of the Audit Authorities. It furthermore takes account of all regulatory provisions, including the use of non statistical sampling in some cases as the best estimate of the risk and the effectiveness of the managing and control system, as well as the "cumulative residual risk" calculated for each programme or groups of programmes since 2012 as indicated above.

Moreover, the Commission notes that the programmes referred to by the Court in box 6 represent 5% and less than 1% of the respective global allocations for the ERDF/CF and the ESF.

## **Box 6 - Overview of the results of the Court's testing of Article 73 conditions being in place (2012)**

(a)

First indent:

When programmes under a common management and control system are grouped for the purpose of the statistical sampling, as provided for in the regulation, the Commission cannot calculate a cumulative residual risk per programme since the audit authorities reports one single error rate for all grouped programmes together. This approach is taken in all cases for all Member States when audit authorities group programmes under a single representative sample.

The six programmes quoted by the Court are part of eight programmes under a common management and control system. The reported and validated error rate for the group of programmes was 2,64% for 2011. The corresponding cumulative residual risk for the group of all eight programmes taken together, after corrections were made by the concerned certifying authority, was below 2%. The Commission therefore concluded that systems are effective for all eight programmes.

Second indent:

All conditions for the granting of article 73 to this programme were already in place at the beginning of 2012. Nonetheless, the Commission decided to follow a prudent approach to address the risk of systemic errors in a specific measure of the programme. It therefore issued a partial reservation in the annual activity report to cover this risk. It was subsequently confirmed by the Member State that the entire expenditure related to this measure was preventively withdrawn already in November 2011 and an action plan was implemented in 2012 to ensure that no expenditure was actually at risk for this measure. Following this conclusion, the partial reservation was lifted in November 2012. Following two on-the-spots audit missions, article 73 was granted to the programme. The positive results reported in the annual control report for 2012 confirmed this assessment with a validated error rate below 2%, and the Commission issued an unqualified opinion in the annual activity report 2012.

(b)

First indent:

- For the two ESF and one ERDF cases mentioned by the Court, the Commission confirms that the concerned audit authorities adequately followed the Commission's guidance note on sampling, given the small size of the population. The Commission notes that the use of sample error rates based on non-statistical samples are foreseen in the regulation in the case of small populations of operations. These are the only available indicators to estimate the overall risk for the concerned programmes and are therefore used by the Commission for the purpose of the assurance process. In such cases, the Commission also takes into account the characteristics of the population and the audit coverage. In two ESF cases, given the small size of the population, the minimum coverage requirement (10%) was met. For the remaining ERDF programme, the use in 2011 of a random selection covering high value items and more than 10% of the expenditure was adequate.
- Furthermore, the Commission based its assessment not only on the error rates reported in the annual control reports, but also on other elements gained through its audit work, such as re-performance of a number of the audit authority's controls on operations and accumulated knowledge on the functioning of the systems concerned.
- As those elements were positive, the Commission concluded that it had a sufficient basis to grant article 73 for those three programmes.

- For the 2013 sample, both audit authorities opted for a statistical sampling method considering the increase of the population's size and the lower threshold triggering the use of statistical sampling set out in the revised sampling guidance provided by the Commission in April 2013.

See also reply to paragraph 36.

Third indent:

Article 73 was granted to these two programmes in June 2012 based on the conclusion that all conditions stipulated in the Commission roadmap had been fulfilled. At that moment the Commission had reviewed the sampling methodology used by the Audit Authority in four consecutive Annual Control Reports since 2008 and found it to be compliant. The information about the change of the sampling method was provided in December 2012 in the new Annual Control Report which was immediately assessed. Based on its assessment, the Commission noted that exclusion of expenditure from the population to be sampled was not in line with the rules. However, it concluded that this change of methodology had no impact on the reported error rates and had been chosen by the Audit Authority for reasons of cost-efficiency since the concerned beneficiaries had already been audited without generating errors in previous years.

The Commission notes that the change of methodology increased the audit coverage from 5% to 20% compared to previous years.

Fourth indent:

The OP referred to by the Court is the fourth smallest OP for ESF. Annual payments in 2010/2012 amounted to 1,5 million euro on average. Despite its very small size, article 74 which sets out proportional control arrangements for small OPs could not be applied since the co-financing rate for this OP is above 40%.

Furthermore, the Commission confirms that it had sufficient ground to grant article 73 to this programme, which has a similar impact to article 74 since, the ESF audit authority adequately followed the Commission's guidance note on sampling, given the very small size of the population which was largely below the threshold required for statistical sampling quoted by the Court in footnote 9 (below 20 projects for 2011 and 2012). Therefore, statistical sampling could not be applied to the population concerned. However the minimum 10% coverage required by the sampling guidance was achieved.

Furthermore, the management and control system for this operational programme was assessed as effective and the error rate reported by the managing authority and validated by the Commission was constantly below 2%.

(c) The Commission considers that it granted article 73 to these two programmes, based on robust, consistent and transparent criteria having taken account of the Court's findings.

In one of the two cases referred to by the Court, the management and control system was assessed as effective and error rates reported by the audit authority and validated by the Commission have constantly been below 2% over the period (2010 - 2012).

For the second case, the Court's findings were not related to the functioning of the audit authority but to other parts of the management and control system and are being followed up. The Commission considers that deficiencies identified in the management and control system in 2013 do not necessarily impact its reliance on the work of the audit authority.

(d) Article 73 was granted to the two concerned audit authorities in June and September 2012. The Court's observation refers to findings disclosed in 2013.

In any case, the Commission confirms, after a thorough assessment of the Court's findings, that these audit authorities fulfil the requirements for article 73. The Commission closely monitors that these requirements continue to be fulfilled under its recent joint audit enquiry on monitoring article 73 (see reply to paragraph 54).

Common reply to paragraphs 49 and 50

As stipulated in the updated roadmap and joint audit enquiry decided in September 2013, and reflected in the Commission services' audit strategy, adequate monitoring of article 73 is carried out through the analysis of national system audit reports and of annual control reports (including fact-finding missions where necessary), on-the-spot work paper review and re-performance of audits carried out by the audit authority and bilateral co-ordination meetings.

See also reply to paragraph 32.

Common reply to paragraphs 51 to 53.

The roadmap was meant as a strategic document to set out the conditions for granting article 73 and for monitoring purposes and not as a methodological document. Following the first batch of Article 73 decisions in the first half of 2012, the methodology to carry out monitoring missions has been developed and the new enquiry has been fine tuned based on the experience of 2 pilot missions carried out in 2012, which included reperformance work and working paper review.

In accordance with the updated roadmap, the joint audit enquiry and the audit strategy, a monitoring mission will be carried out for every audit authority with article 73 status in principle every 2nd year. These monitoring missions are including reperformance work and working paper reviews, in line with international auditing standards.

Common reply to paragraphs 54 and 55

DG Regional and Urban policy indicated in its 2012 annual activity report that based on its monitoring of the programmes with a single audit status conditions were still in place to justify this status, since the audit authorities had appropriately reported new deficiencies for some of the concerned programmes. Thus the concerned audit authorities continued to function appropriately.

In September 2013 the Commission has formally updated its initial roadmap and adopted an audit enquiry setting out the methodology and process for the monitoring of the 'single audit' status. Annex I of the updated roadmap contains an overview of actions/corrective measures in case one or more of the initial conditions to arrive at the implementation of the single audit principle are no longer complied with.

The Commission monitors all concerned programmes, including through re-performance work. At the end of 2013, the Commission's monitoring covers nineteen OPs with an article 73, for seven audit authorities in line with the Commission's audit methodology. Specific corrective measures are being implemented for four audit authorities.

DG Employment did not identify any issues in its 2012 annual activity report warranting a reconsideration of the operational programmes that have been granted article 73 in 2012. Therefore, no corrective actions had to be initiated in order to withdraw or suspend the single audit status granted in 2012. Furthermore, the Commission started monitoring missions on these OPs in late 2013.

56. The closure will build on the extensive audit and monitoring work performed during the period, in particular with respect to the annual assessment of the cumulative residual risk by programme. See also reply to paragraphs 49 to 53 on the updated roadmap and audit enquiry on monitoring.

The Commission also draws the attention to the fact that the implementation of the single audit concept will also continue in the period 2014-2020 as stipulated in Article 140(3) of the Common provisions Regulation [footnote: “*For operational programmes for which the Commission concludes that it can rely on the opinion of the audit authority, it may agree with the audit authority to limit the Commission’s own on-the-spot audits to audit the work of the audit authority unless there is evidence of deficiencies in the work of the audit authority for an accounting year for which the accounts have been accepted by the Commission*”].

60. The Commission issued guidance over the first years of implementation which is essential for the audit authorities’ work (e.g. compliance assessment, audit strategy, assessment of management and control systems, sampling methods). These guidance documents were issued on time at the beginning of the programming period (see paragraph 62).

Common reply to paragraph 61 and Box 8

Guidance on complex issues, such as the ones quoted by the Court, is necessarily based on good and bad practices identified during the first years of implementation. Draft guidance is discussed during various technical meetings with the audit authorities before being finalised in the COCOF meeting. This was in particular the case for the guidance on the treatment of errors which was extensively discussed with audit authorities before being formally communicated.

66.

First indent:

The Commission agrees that this compulsory information could be further complemented through additional guidance as far as results of operations are concerned. The Commission intends to provide additional written clarification to audit authorities in this regard by the end of 2013.

Second indent:

The Commission obtains additional information on the results of audits of operations, either on a writing form or during on-the-spot fact-finding missions, when required, based on its risk assessment (see reply to paragraph 32).

The Commission will consider the possibility to issue further written clarification on this issue.

Third indent:

At closure, audit authorities are already required to do a multi annual assessment of the functioning of the management and control systems as well as of the corrective capacity at closure (see closure guidance issued in 2013).

Fourth indent:

Concerning the impact of subsequent events on the audit opinion, this is already partly covered in the guidance on the treatment of errors issued in December 2011 as far as ‘positive’ events are concerned.

The Commission will consider the possibility to issue further written clarification on this issue.

The Commission has made proposals to cover all previous aspects in the implementing / delegated acts for the 2014-2020 programming period to further harmonise implementation.

67. The regulation and as a consequence the guidance issued by the Commission take account of international audit standards but have to reflect the specificities and terminology used for cohesion policy.

Common reply to paragraphs 68-69

The extensive audit work to review the work of audit authorities since 2009 also entailed a comprehensive capacity building exercise with the concerned audit authorities. This allowed in its turn an exchange of good practices with all audit authorities through additional guidance and technical meetings.

72. The Commission continues to provide training to audit authorities, in particular on sampling techniques, on the audit work in the view of closure of the 2007-2013 period and on the audit for the new programming period.

73. The Commission notes that granting article 73 to some programmes does not reduce its control work. The main advantage for the Commission lies in the possibility to focus its limited audit resources to higher risk programmes and authorities rather than reduce its control work overall. Moreover, single auditing does not mean no audit at all. Monitoring and follow-up missions remain necessary to ensure the continued reliability of the audit work of the national audit authorities.

Common reply to paragraph 74 to 76

The Commission underlines that through the regulatory framework for 2007-2013, the level of assurance it can obtain has increased significantly, in particular by allowing assessing the assurance for each operational programme each year as from the start of implementation. Therefore the cost of controls should be assessed from a cost-efficiency perspective rather than in absolute terms.

The Commission notes that the Funds may finance the preparatory, management, monitoring, evaluation, information and control activities of programmes through technical assistance.

77. Following years of high error rates in the period 2000-2006 the Commission, decided to propose reinforced management and control provisions, including statistical sampling, for the 2007-2013 period. These proposals are largely reflected in the current legislative framework. The Commission notes that in the current programme period error rates are significantly lower.

78.

The Commission anticipates that the costs of control for the 2014-20 programming period will remain stable.

With the different audit simplifications foreseen in the regulation, the reduction in administrative burden (for example reduced reporting requirements and extended use of simplified cost options) or the use of updated guidance on sampling may lead to considerable gains in audit effort.

This would more than compensate the additional efforts needed to audit the accounts and to review the management declaration.

Common reply to 79 and 80

The Commission welcomes the Court's conclusion. The Commission also considers that the Member States and the Commission have reinforced the internal control framework for 2007-2013 programmes compared to previous programming periods. The Commission considers that this contributes to ensuring a robust audit capacity across the Union.

83. With regards to the risks identified by the Court, the Commission has the following position:

First indent:

Since 2009 the Commission carried out extensive audits on the spot to review the work of audit authorities. It carried out 269 audit missions and reviewed 47 and 84 Audit Authorities for ERDF and ESF. This covers approximately 96% and 99% of the total allocations, respectively. These reviews allowed the Commission to give advice, to contribute to capacity building and to recalculate rates or replace them by flat rates if these were considered unreliable.

Overall, the Commission has a thorough process to verify the reliability of the error rates reported by the audit authorities which are revised where appropriate. The fact that the error rates reported in the annual activity reports of DG Employment and DG Regional and Urban Policy are in line with the error rate established by the Court corroborates the reliability of the auditing and reporting system.

Second indent:

The Commission has also put in place a robust methodology to verify and validate the error rates reported by the Audit Authorities, including where necessary, additional requests of information and/or on-the-spot fact finding missions (in 2013, 64 ERDF/Cohesion Fund OPs in 11 Member States and 23 ESF OPs in 10 Member States).

The good knowledge gained on the functioning of a large number of audit authorities through its extensive audit enquiry proved to be very useful in the Commission's assessment of the reported error rates.

Third indent:

The Commission considers that the cumulative residual risk, which takes into account the error rates and financial corrections over the programming period, is an indicator of the overall corrective capacity of the programmes assessed each year by the Commission in its annual activity reports.

It is based on all available reported data for the previous years and the best estimate of the year under assessment.

It helps the Commission to tackle in particular but not exclusively the situation of programmes with validated annual error rates between 2% and 5%.

Such programmes, which were safe from reservations in the past, can now be subject to a reservation and subsequently to legal proceedings (interruptions/suspensions/ financial corrections).

Thanks to the use of the cumulative residual risk, additional programmes are put into reservation, thereby mitigating the risk identified by the Court of an under-estimation of the risks for those programmes.

Furthermore, the Commission has conducted specific risk-based audit work in order to ensure that the corrections reported for 68 OPs over the last 3 years are effectively implemented and, in case of doubts or insufficient evidence, deducts the amounts concerned from the cumulative financial corrections taken into account for the purposes of the calculation of the residual error rate.

The Commission always aims at ensuring that the reporting made to the Discharge Authority gives a fair and reliable picture of the estimated risk affecting the EU budget for each Member State, taking also account of the multiannual corrective capacity. The Commission services provide all available information in full transparency in their annual activity reports.

The Commission thoroughly reviews each year the error rates reported by audit authorities. This verification process, together with the extensive results from its audit enquiries, allows the Commission to disclose full and reliable validated error rates in the annual activity reports and to make appropriate reservations when necessary.

To illustrate this, the Commission considers that the fact that for three years in a row for DG Employment and two years in a row for DG Regional and Urban Policy the Commission's own estimated error rate as disclosed in the annual activity report is in line with the Court's error rates confirms the validity and reliability of its approach.

## **Recommendation 1**

The Commission considers that this recommendation is already implemented.

The Commission has a thorough verification process in place, including on-the-spot fact-finding missions, in order to ensure the accuracy and reliability of the error rates reported by audit authorities. It alternatively uses flat rates when it considers error rates as unreliable. This process is complemented by an exhaustive Commission audit enquiry since 2009 whereby 269 audit missions allowed reviewing the work of audit authorities, including through re-performance, covering around 90% of Funds allocations. The Commission also carries risk-oriented audits to verify the accuracy of reported financial corrections.

The Commission will continue to ensure a strict supervision of the reported error rates, to monitor and review the work of the audit authorities, and to make targeted audits on the quality of the certifying authorities' processes to record and report financial corrections.

## **Recommendation 2**

The Commission has introduced in its proposal for Common Provisions Regulation for 2014-2020 and the legislator has agreed on the possibility for net financial corrections in the event of serious irregularities identified after the submission of the annual accounts and not previously detected and/or reported by the audit authority.

The Commission also intends to propose in the secondary legislation that flat-rate corrections can be increased for repeated breaches involving the same deficiencies, where the Member State has failed to take adequate corrective measures for that part of the system that was affected and subject to a previous correction.

84. The figures described by the Court result from the strict conditions foreseen in the regulation which require comprehensive audit work by the Commission and the Member State, including re-performance work in accordance with international auditing standards, before being able to assess the functioning of the whole management and control system. In addition, the Commission had to wait that error rates be delivered in 2010 or even in 2011 in most cases due to the slow take off of implementation. The Commission had to carefully verify these rates as well as the results of its first on-the-spot re-performance of the work of the audit authorities to assess the effectiveness of the implementation of management and control systems.

85. Based on its own assessment, the Commission strongly disagrees for all of the 15 cases mentioned in box 6 and considers that the requirements are in place at the end of 2013 for all 61 programmes. In its assessment, the Commission bases itself on the results of the extensive audit enquiries started in 2009 to effectively verify the reliability of the Audit Authorities. It furthermore takes account of all regulatory provisions, including the use of non-statistical sampling in some cases as the best estimate of the risk and the effectiveness of the managing and control system, as well as the "cumulative residual risk" calculated for each programme or groups of programmes since 2012 as indicated above. In addition, the objections raised are particularly unsuitable for small OPs.

Moreover, the Commission notes that the programmes referred to by the Court in box 6 represent 5% and less than 1% of the respective global allocations for the ERDF/CF and the ESF.

86. Since the audit of the Court, the concerned Directorates general of the Commission have jointly developed and adopted in September 2013 an audit enquiry to monitor the article 73 decisions granted for the first time in 2012. In addition, they have taken a joint decision updating the roadmap to article 73 and the monitoring processes in September 2013.

see below reply to recommendation 4

### **Recommendation 3**

The Commission considers that the single audit status was granted based on robust, consistent and transparent criteria. It furthermore considers that by the end of 2013 all requirements are fulfilled for these programmes.

The Commission will continue to apply a robust approach, further clarified with the implementation of its roadmap on article 73, up-dated in September 2013.

### **Recommendation 4**

The Commission considers this recommendation is implemented through the updated roadmap and the audit enquiry on monitoring article 73 adopted in September 2013.

Following the granting of the first batch of article 73 decisions in the first half of 2012 and based on pilot missions, the Commission services developed an audit methodology to carry out monitoring missions which include re-performance work and working paper reviews, in line with International Standards on Auditing.

87. The Commission welcomes the Court's assessment and is continuing its close cooperation with audit authorities to constantly improve its guidance and support. The Commission is actively promoting the implementation of its revised guidance on sampling from April 2013 through training seminars in various decentralised Member States, to ensure adequate dissemination of the information to all concerned audit authorities in these Member States.

The Commission has started the dialogue with audit authorities to adequately prepare for the launching of the 2014-2020 period, and to improve the secondary legislation on matters related to the work of the audit authorities.

### **Recommendation 5**

The Commission agrees with this recommendation and is taking measures to ensure improved secondary legislation and timely and complete guidance within a stable methodological framework for the work of the audit authorities, building on the accumulated experience of the 2007-2013 programming period.

The Commission will further clarify some aspects of the existing guidance through written clarification by the end of 2013.

Furthermore, according to the regulation for the 2014-20 programming period, the Commission is empowered to adopt, by means of implementing and delegated acts, binding models and/or requirements for the audit work of audit authorities that should build up on the experience and good practices of the 2007-2013 programming period.

89. Under the Treaty, Financial Regulation and sector specific regulations the division of responsibilities is clearly established. Within the context of the European Structural and Cohesion Funds a substantial technical assistance budget is available to Member States. They have to decide how to use this allocation.

See also Commission reply to recommendation 6.

### **Recommendation 6**

The Commission considers that this recommendation is already implemented in the 2011 Impact Assessment (see footnote 71). It further notes, under shared management and in respect of the principle of subsidiarity, the decision to allocate technical assistance to the different cost categories is taken by the Member States.

Furthermore, in the 2014-2020 regulation, the Commission reinforces its cost-efficiency approach for Cohesion. As a consequence, the newly designed arrangements for the implementation of the funds including in relation to controls, "(...) *shall respect the principle of proportionality having regard to the level of support allocated and shall take into account the overall aim of reducing administrative burden for bodies involved in the management and control of the programmes*".