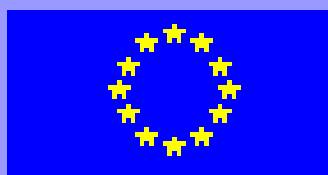


Report
to the
Contact Committee
of
the Heads of the Supreme Audit Institutions of the
EU Member States and the
European Court of Auditors



On the
**Parallel Audit of the Management and
Control Systems for Assistance Granted
under the Structural Funds**
by the Working Group on Structural Funds

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(in separate edition)

Executive Summary

Background and main conclusions

1. In 2000 the Contact Committee of the Heads of the Supreme Audit Institutions (SAIs) of the EU Member States and the European Court of Auditors (the Contact Committee) established a Working Group¹ to carry out an exploratory survey of EU structural funds. This work was undertaken to gain an understanding of how these funds were controlled and managed by the Member States and to identify possible risk areas that the Contact Committee might focus further investigations on as part of the structured programme. Subsequently the Contact Committee agreed that the Working Group should carry out a parallel audit on the application of the Structural Funds regulations, to ensure that all Member States establish appropriate audit trails and implement independent checks on 5% of transactions. The results of the audit would be used by all current and prospective new Member States in developing their own management and control systems.
2. In order to undertake this work, the Working Group developed an Audit Plan (Appendix), to be used by SAIs in carrying out their respective national audits. Each SAI has worked to this common format and produced their respective Country Report to a deadline of 31 May 2004. As guided by the Core Group of Germany (Chair), Denmark, the Netherlands and the United Kingdom, the Working Group have then finalised this combined report summarising the key findings and recommendations from those Country Reports.
3. Our main conclusions are:
 - In most countries there is a sufficient audit trail as required by Commission Regulation 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds (OJ L 63/21). Although some weaknesses in the audit trail were noted when examining individual projects, these were not usually systematic weaknesses, but individual project failings. The most significant weaknesses identified were the lack of complete documentation of the examinations carried out, and the lack of a definition of the distinction between irregularities and simple errors.

¹ Denmark (DK), Finland (SF), Germany (D), Italy (I), Netherlands (NL), Portugal (P), Spain (E), Sweden (S), United Kingdom (UK), ECA (with observer status)

- The progress reporting of projects was felt to be relatively weak, focussing largely on financial monitoring without providing any link to the outputs and outcomes of the projects.
- In most countries the execution and reporting of the 5% checks complied with Commission Regulation 438/2001. Where this is not the case, the relevant authorities have taken steps in the right direction to ensure that the required checks will be carried out by the end of the programming period.
- The independence of the organisations that carry out the 5% sample checks was guaranteed in all programmes.
- The implementation of the 5% checks across all countries has been relatively slow and has often not been evenly spread over the period to date.
- The way the Structural Fund rules are formulated by the European Commission (Commission) leaves room for ambiguous or even contradictory interpretations.
- Furthermore, some Member States expressed concern about an increasing burden to implement the new provisions for the 2000 - 2006 Programme, with little opportunity to apply a risk-based approach, and associated resource costs that were out of proportion to the funding provided by the European Union.

Good practice

On the audit trail

4. Checklists can be used as an aid to help ensure compliance with requirements and to assist in standardising country practices.
5. The approval of project systems in advance helps reduce the risk of payments being made to projects where systems are inadequate. Such risks can also be reduced by examinations during the final application approvals stage, or as a part of the audit of the first payment request.
6. The submission of supporting documents with requests for payment allows for a more detailed and timely review of claims by the paying authority. In the absence of supporting documentation, independent certification of payment requests is an alternative approach which

provides adequate assurance regarding the validity of the claim.

7. Project progress reports validated through both project visits and comparison with other known information help ensure that a consistent view is presented of individual projects.
8. Progress reports should address both financial and performance objectives. Financial information will always be important but performance information should also be provided to compare project progress with expenditure. Even when there is not a direct correlation between project progress and expenditure, for example, where final outcomes only accrue some time after all funds have been expended, performance information should still be provided.
9. The internal audit units of the national authorities can play an important role in ensuring that regulatory requirements are being met and provide a catalyst for sharing good practice and encouraging continuous improvement. Similarly, when carried out earlier in the programming period, the 5% inspection work at projects can also be designed to contribute to the confirmation of the quality and operation of the audit trail.

On the 5% checks

10. Annual risk assessments and a formalised and systematic sample selection approach can lead to the detection of system errors which might otherwise go undetected.
11. After carrying out a 5% check a visit report is drafted with recommendations for the project audited, providing timely feedback and opportunities for future projects to apply lessons learnt.
12. Annual systems reviews carried out should include following-up on the findings and recommendations from previous audits.
13. Use of a standard checklist helps ensure a consistent approach and report.
14. Audited bodies are proactive in assessing whether or not the objectives of the projects have been fulfilled.

Recommendations

On the Audit Trail

15. While project monitoring operates effectively for most projects, where projects are already completed, the impact of the project should be assessed before approval and the

requirement for progress reports dispensed with (retrospection).

16. The eligibility rules should be reviewed so as to ensure that Structural Fund support can be directed to achieve best value for money.
17. There should be a risk-based assessment of the need for the verification of claims, whether by independent certification or submission of supporting documentation, or reliance on the work of internal audit.
18. Guidance could be produced for Member States internal audit units, to use in ensuring that regulatory requirements are being met, and also serve to minimise the audit burden falling on those in receipt of structural fund support.

On the 5% Checks

19. The new Structural Funds regulations (post 2006) should contain a legal obligation to spread the execution of the 5% checks more evenly over the programme period.
20. The audit of the management and control systems should be given a higher priority to detect weaknesses in the systems at an early stage of the programming period.
21. Risk assessments should be routinely used when selecting projects for the 5% checks (see Annex C for risk factors to be considered).
22. Member states should try and convince the Commission to provide guidance on the interpretation of Article 5 of Regulation 438/2001 in respect of the examination of the management and control systems. This would help the managing authorities to improve their systems.

Future Parallel Audit considerations

23. In carrying out this review, other risk areas were identified which might warrant further investigation and reporting. These are summarised below:
 - ***Irregularities*** - a review of the processes in place in all Member States for identifying, reporting and following-up on irregularities, in compliance with Commission guidance;
 - ***Performance of 2000-2006 Structural Funds*** - a review of the performance to date, focussing on the content and quality of the mid-term evaluations carried out in 2003 and of the critical examination by the Commission that links to the achievement of the Performance Reserve;

- **Article 15 Closure of the 2000-2006 Programme** - to examine the lessons learnt from the exercise in respect of the 1994-99 Programme, and to review how all current Member States are prepared for the 2000-2006 closure exercise.
24. On balance it was agreed that the review of Irregularities would be an appropriate topic to be considered for the next review, as it would afford a good opportunity for wider participation by all Member States and would provide timely recommendations on compliance with the Commission regulations and guidance. On the other hand, auditing mid-term evaluation and closure of the programme would allow taking into consideration performance and value for money, as well as goal orientation of the programme and projects.

Part One Introduction

Background

- 1.1. In total the 2000-2006 Structural Funds programme involves an expenditure of 141,5 billion Euro (without Community initiatives, innovative measures and technical assistance) to the nine Member States whose SAIs carried out the parallel audit (detailed at Annex A).
- 1.2. The significance of the value of Structural Funds to all Member States prompted the Contact Committee in 2000 to establish a Working Group to carry out an exploratory survey of EU structural funds. A questionnaire was sent to the SAIs to gain an understanding of how these funds were controlled and managed by the various countries and to identify possible risk areas. Work was planned to coincide with the 2000-2006 funding cycle and revision of the regulations covering the funds, most notably Council Regulation 1260/1999, of 21 June 1999, laying down general provisions on the Structural Funds (OJ L 161/1); and Commission Regulation 438/2001. The Working Group reported its findings from this work to the Contact Committee in November 2002.
- 1.3. The Working Group recommended to the Contact Committee that a parallel audit should be conducted which aims to identify parts of the controls that need to be improved, and provide an overview of best practice. It was determined that the best way to achieve this was to focus the parallel audit on the application of the regulations, to ensure that all Member States establish appropriate audit trails for transactions and implement independent checks on 5% of transactions. The results of the audit would be used not only for the then Member States, but also for the new Member States.
- 1.4. The Contact Committee at their meeting on 27 and 28 November 2002 acknowledged the Working Groups report, which analysed and presented the results with a risk-based focus. They noted the proposal that the Working Group should focus their work on the area of “the Audit Trail” and “the 5%-check” which it was considered offered the best opportunity for continuing the existing widely inclusive approach. The Contact Committee mandated the Working Group to continue accordingly and agreed:
 - that the Working Group would carry out its work in such a way as to provide an interim progress report to the 2003 Contact Committee; and,
 - that the Working Group would aim to produce a final report in time for the 2004 Contact Committee.

- 1.5. In order to comply with the 2002 mandate the Working Group developed an Audit Plan (Appendix) to be used by SAIs in carrying out their respective national audits. Each SAI has worked to this common format and produced their respective Country Reports to a deadline of 31 May 2004. Each SAI produced a Country Report which has been consolidated to provide an overall conclusion, identify good practice, weaknesses and recommendations arising from the work. Issues raised by individual SAIs are annotated under each Objective where appropriate. The Working Group have then produced this combined report summarising the key findings and recommendations from those Country Reports.
- 1.6. The Working Group has kept all new Member States informed about the study and has provided them with details of the planned audit work.
- 1.7. The coverage by each of the SAIs is set out at Annex B. All Funds and Objectives have been covered in the conduct of the work which underlies this report.

Audit approach

- 1.8. The overarching objective of this report was to capture the SAIs' judgments in identifying those parts of the controls within the regulations that need to be improved and provide an overview of good practice in their implementation. In order to ensure a consistent approach, the Working Group issued the Audit Plan referred to above, which addressed the key requirements of both the audit trail and the 5% checks as set out in Commission Regulations. The audit programme consists of a series of audit objectives, supplemented by more detailed guidance under each objective; although it was left to each SAI to decide on the most appropriate audit approach to address those objectives. These objectives have been used to provide the structure of Parts 2 and 3 of this report.
- 1.9. The Working Group acknowledges that constraints within Member States have influenced the coverage of the Country Reports across the Funds, Objectives and Programmes; these include resource availability and the access rights of SAIs.
- 1.10 In reporting the results country references are given against examples of good practice. This does not mean, however, that similar good practice was not operating in other Member States. Under some Objectives no examples of good practice or weaknesses were identified.
- 1.11 The audit approach was enhanced through the participation of the European Court of Auditors (ECA),

who sat as observers on the working group. The working group would like to thank the ECA for their valuable role played in the parallel audit process. In particular, towards the end of the report drafting process the ECA benchmarked the draft report findings and recommendations against those reported by the ECA, which gave assurance over the comparability of results.

Part Two Audit trail

Introduction

- 2.1. The objective of an Audit Trail is to provide assurance that each and every transaction is subjected to proper control throughout its life (“from cradle to grave”). From an audit perspective, the key aspects that have to be addressed are completeness, timeliness, accuracy, eligibility, regularity, recording and reporting of transactions.
- 2.2. Article 7 of Regulation 438/2001 refers specifically to the need for “Member States’ management and control systems to provide a sufficient audit trail.” But this provides only the broad principles required for an effective audit trail and does not provide a complete, coherent framework. Specific controls and procedures are referred to in several different areas of the governing regulations on Structural Funds and with different levels of detail and definition.
- 2.3. As a result the Working Group created their own framework for the audit, building on the principles in the regulations but also using their professional appreciation of the requirements of an effective audit trail. Key objectives were set which required audit activity at both the level of the Member State or programme authorities and at the project level. The detailed audit approach and techniques to be adopted were left to individual SAs to decide.
- 2.4. The resulting report on the audit trail is in three parts: Objectives 1 – 4 dealing with issues at the programme level; Objectives 5 - 7 dealing with issues at the project level; and finally Objective 8 provides comments on any other issues relevant to the audit.

Audit Findings by Objectives

Objective 1: Do the managing authorities² have adequate procedures for ensuring the administration of applications?

Conclusion

All SAIs concluded that the managing authorities have adequate procedures for the administration of applications which reflect the objectives of the programmes; although the findings identified some weaknesses.

Findings

Most of the managing authorities have adequate measures to ensure that all applications are recorded and dealt with appropriately. Applications must be submitted using standard application forms and are often processed by comprehensive IT-systems and using checklists for each step in the evaluation process. However, such checklists are not always used to their full extent.

Most managing authorities have established clear criteria to evaluate applications and have applied them consistently. On occasion, other additional criteria have been applied which impairs the consistency of this process.

Most project managers find it difficult to identify clear measurable objectives when formulating an application. Therefore, most of the managing authorities find it problematic to develop procedures for evaluating the formulated objectives and appraising the underlying financial plan.

Some managing authorities have difficulties in confirming the additional value gained from EU funding and in preventing the double-funding of the operations.

One country was prepared to accept less information in respect of applications from smaller operations, where there were limited resources to apply.

Good practice

Some SAIs commended the use by managing authorities of identification numbers for applications (incl. all supporting documentation) from the point where applications are first received. This guarantees completeness in that all applications can be identified individually and that all relevant information is evaluated and retained (e.g. D, DK, S, UK).

All managing authorities use standard application forms which increase the quality of the evaluation process. Some managing authorities publish the application forms on the

² including intermediate bodies

internet along with suitable guidelines, to make them available to potential project managers (e.g. DK, SF, UK).

Some managing authorities have informal discussions with project managers in the early stages of the evaluation of applications to increase the quality of the applications and thereby reduce the time spent on reviewing non-viable applications, which were rejected (e.g. D, NL, UK).

One managing authority has a central IT-system in which checks for double-funding can be performed electronically and prior experiences with the project manager can be recorded (I).

Recommendations

Improved guidance should be developed to help project managers formulate clear objectives in their applications.

Rejected and amended applications should be registered in the same way as approved applications. This gives the managing authority a complete audit trail by which all applications can be identified and analysed.

The managing authorities should have standard procedures for handling rejected or amended applications, and complaints.

Objective 2: Do the managing authorities have adequate procedures to ensure the payment of funds?

Conclusion

Most SAIs concluded that the managing authorities have adequate control and management systems for payment of funds to final beneficiaries and for handling errors appropriately; although the findings identified some weaknesses.

Findings

All managing authorities require the use of a standard form for the payment request sent by the project manager. Some managing authorities have developed IT-systems in which the payment requests are transferred electronically and recorded automatically upon receipt.

All managing authorities have defined what supporting documentation is required for payment applications, although a variety of practices exist. Some managing authorities require the project manager to provide copies of documentation such as invoices to support the payment request; one only requires the list of transactions; while others do not require any supporting documentation to be provided. Finally, some demand that the payment request is certified by qualified independent auditors.

All managing authorities have procedures to ensure that actual expenditure is compared to the original budget and that actual expenditure is consistent with project activity. Tests evidenced that some managing authorities did not document satisfactory compliance with these procedures in all the files examined.

All paying authorities have systematic payment arrangements that ensure that there are no significant delays in payments to final beneficiaries.

All managing and paying authorities have procedures for handling irregularities according to Commission Regulation 1681/94 of 11 July 1994 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the structural policies and the organization of an information system in this field (OJ L 178/43) and for reporting irregularities to the Commission.

All SAIs agreed that a clearer definition of the distinction between an error and an irregularity would be desirable.

Good practice

The managing or paying authority uses a standard letter to advise project managers of errors in payment requests (e.g. DK, UK).

One SAI identified an example where the managing authority publishes an online handbook with FAQ's on eligible costs, which can be helpful to the project managers when issuing the payment requests (DK).

Another managing authority published an integral handbook of procedures for administration, follow up and control of the Structural Funds, in which the functions and responsibilities for the whole activity generated by these resources are regulated. This handbook obtained the certification ISO 9001 (E).

Weaknesses and recommendations

Weakness

Managing authorities have difficulties in checking the link between the projects activity and the financing because payment requests only have a financial focus.

Recommendations

The need for supporting documentation is handled in different ways across the managing authorities. The managing and paying authorities should consider the need for supporting documentation when designing their systems. The systems should be designed to address all risk factors known to the managing and paying authorities while not unnecessarily overloading the project managers.

Commission Regulation 1681/94 has a broad definition of the concept of an irregularity. It is considered important by all SAIs that this be elaborated to provide guidance that will allow managing and paying authorities to more consistently differentiate between an irregularity and a simple error.

Objective 3: Does the authority have financial and accounting systems which ensure that expenditure is correctly recorded and properly allocated?

Conclusion

Most SAIs concluded that paying authorities have systems in place to accurately record and allocate payments made at Programme level and that such documentation is retained throughout the programme and winding-up periods; although the findings identified some weaknesses.

Findings

All payment transactions are recorded separately at the Programme level in the managing and paying authorities' IT systems. Some managing and paying authorities have problems with IT-systems which generate unreliable data either because of poor controls, or because of errors made when data is entered into the system.

Reconciliation between the managing and paying authorities' systems is carried out in all programme authorities; although the frequency differs between monthly, to each time a payment request is submitted to the Commission.

The final recipient can be identified in all paying authorities either directly in the payment system or in underlying payment systems at intermediate bodies.

Good practice

In one instance, an IT system was used to hold both payment information and other related information, from which reports can be generated automatically (S).

The key prerequisite for an effective IT system is that all controls should be built into the system and tested regularly (I).

Weaknesses and recommendations

Weakness

Some managing and paying authorities are co-located within the same organisation and as a result one SAI has identified that there is not adequate segregation of duties.

Recommendation

If the Programme authority chooses to develop a centralised shared grant administration system which has interfaces for both operators and the involved managing and paying authorities, the system should be properly tested and documented before it is implemented. Some SAIs have found that such a system was

implemented without being properly tested, which has had a major impact on the entire management system, as some parts of the system did not function effectively and hence manual checks had to be carried out.

Where the managing and paying authorities are co-located, clear job descriptions are necessary to ensure that there is adequate segregation of duties.

Objective 4: Are there sound arrangements to ensure that payments requests to the Commission are made using the appropriate exchange rates and accurately reflect the amount paid to and due to recipients?

Conclusion

Payment requests to the Commission are complete and accurate and the systems ensure that the funds are allocated to the correct recipients.

Findings

All paying authorities prepare and verify payment requests prior to submission to the Commission. One paying authority, however, did not carry out these responsibilities independently from the managing authorities.

Some member states have delegated the submission of payment requests to the Commission to different paying authorities. This has led to differing procedures being used within Member States and has occasionally resulted in the Commission challenging the payment requests.

All paying authorities verify that the funding is allocated to the correct recipients once it is transferred from the Commission.

The review findings confirmed that the correct exchange rates were being used by non-euro member states.

Good practice

One SAI identified that the paying authority sets a time limit by which the payment request from the project manager should result in a transfer of funds. This increases the focus on transfer periods and prevents delays (DK).

In another instance the paying authority carries out additional sample checks on a fixed percentage of the underlying transactions included in a payment request to the Commission. Providing this sample is representative of the total population, this approach should reduce the probability of errors arising (UK).

One intermediate body has implemented procedures to guarantee through IT that certified payments sent to the paying authorities only include the payments registered in the accounting of the different managing bodies (E).

Both the managing authorities of the ERDF and ESF have implemented effective IT data systems for the administration and integrated control of the funds (E).

Recommendations

The payment request to the Commission is a consolidated request of underlying payment requests submitted to the paying authority. Where reliance is placed on the controls operated by authorities at lower levels in the payment procedure it is important that those controls are fully tested to ensure that payment requests to the Commission are accurate and reliable.

Objective 5: Have eligibility rules been followed in selecting project managers and projects for Structural Fund support?

Conclusion

The eligibility rules are followed in selecting project managers and projects. In particular, the final beneficiaries are correctly identified and projects are eligible for Structural Fund support.

Findings

No countries reported any difficulties regarding the identification of final beneficiaries. Similarly, the selection of project managers and projects is carried out in accordance with the regulations. In some instance checklists are used to assist in confirming eligibility for support. One country reported a lack of evidence to confirm compliance in some minor areas, but this did not detract from an overall positive conclusion.

While all SAIs have concluded that eligibility rules have been followed, some countries commented that these rules themselves are drawn very widely leading them to question the efficiency of the support mechanism. This has led to projects being funded in retrospect; receiving support even though they were already completed.

Good practice

The use of a checklist to confirm eligibility helps ensure a consistent approach to confirming compliance with requirements (e.g. DK, S, UK)

One managing authority has a central IT-system which maintains project details (I).

Weaknesses and recommendations

Weakness

The eligibility rules are drawn so wide that projects have been eligible for support even though the projects had already been completed, or even before Programmes had been approved by the Commission. This raises questions regarding the efficiency and effectiveness of the support.

Recommendation

The eligibility rules should be reviewed so as to ensure that Structural Funds support can be directed to achieve best value for money, rather than just to achieve spend targets.

Objective 6: Has the project implemented appropriate systems to ensure that receipts and payments are accurately recorded in the accounting system, assets are correctly recorded, and that these amounts are correctly reflected in demands for payment?

Conclusion

Most SAIs concluded that appropriate systems are implemented to ensure the accurate recording of receipts, payments and assets and that amounts are correctly reflected in demands for payment. Where there are doubts regarding the systems, these arise because not all SAIs visited projects, but relied on information gained through responses from projects to questionnaires, which in turn were not always complete.

Findings

The use of a consistent grant system, or common accounting regime and national requirements, helps to ensure that systems are satisfactory. Other countries either require the submission of copies of all supporting documents for each claim or require claims to be certified to help ensure the completeness and accuracy of payment claims. In one case, the project systems are approved in advance as part of the final approval of the project application. In another instance, the project systems are subject to a full audit when the first payment request is received.

The assurance that can be taken from the work of internal and external audit functions operating within projects is variable. Only two SAIs reported both an effective internal and external audit function, whilst one SAI reported an effective internal audit function. These three SAIs also acknowledged that the presence of an internal audit function is less likely in projects operated by smaller organisations.

Good practice

The approval of project systems in advance helps reduce the risk of payments being made to projects where systems are inadequate. Such risks can also be reduced by examinations during the final application approvals stage, or as a part of the audit of the first payment request (DK, E).

The submission of supporting documents with requests for payment allows for a more detailed review of claims by the authorities (e.g. I, P, S) In the absence of supporting documentation, independent certification of payment requests is an alternative approach which might provide adequate assurance regarding the validity of the claim (e.g. D, SF).

Weaknesses and recommendations

Weakness

The use of a uniform approach to independent certification of claims or requiring supporting documentation for claims ensures consistency, but is inefficient and does not acknowledge the differing risks attached to different claims.

Recommendation

There should be a risk-based assessment of the need for the verification of claims, whether by independent certification or submission of supporting documentation, or reliance on the work of internal audit.

Objective 7: Is progress made truly and fairly reflected in any reports or other information submitted to Programme authorities?

Conclusion

Projects have established procedures to monitor and report on progress to programme authorities; although these procedures were not always consistently documented.

Findings

Most SAIs reported that payment requests are accompanied by progress reports and typically, payments will only be authorised when the progress report has been approved.

All SAIs agreed that progress reports should be monitored for their submission and should contain both financial and performance information.

Good practice

Project progress reports are validated through both project visits and comparison with other known information, which helps ensure that a consistent view is presented of individual projects (e.g. D, NL, SF).

Progress reports address both financial and performance objectives. Financial information will always be important but performance information should also be provided to compare project progress with expenditure. Even when there is not a direct correlation between project progress and expenditure, for example, where final outcomes only accrue some time after all funds have been expended, performance information should still be provided.

Weaknesses and recommendations

Weaknesses

While the reporting process operates effectively for most projects, where projects are approved retrospectively, the usefulness of the project progress reports are reduced. In such cases reports are prepared and submitted simply to ensure compliance with the Regulations, without containing any information on the progress of the project.

In one case, however, it was reported that the progress reports tended to focus on the financial information and even that, at

times, was incomplete. It was also noted that no assessment of the impacts of a project was made after the project was completed and the final report submitted.

Progress reports should also be monitored for performance against the project's objectives. In one case it was reported that the managing authority had failed to ensure that projects achieved their targets or to pass on experience gained from their examination to implementing bodies.

Recommendation

Where projects are already completed, the impact of the project should be assessed before approval and the requirement for progress reports dispensed with.

Objective 8: Other relevant matters arising from the audit

Conclusion

The overall conclusion is that there is a sound audit trail as required by Commission Regulation 438/2001. Some SAIs identified that the administrative arrangements within their own Member State could be improved so as to improve the efficiency of their operations.

Findings

One SAI pointed out that administration of individual Programmes varied, and that in the case of one Programme, decentralisation had resulted in an individual project being analysed and discussed at least five times before a decision for approval could be reached.

Another SAI reported that the administration of the ESF was being reorganised in order to comply with the Commission's recommendations to rectify errors and shortcomings identified in the past.

There were contrasting findings on the level of internal audit examination of Structural Fund systems and control. In one instance it was felt that internal audit performed a very important role, providing an ongoing review of systems and making many constructive recommendations in the form of Action Plans. In another case, it was found that internal audit only carried out a very limited review of the decentralised programmes.

Good practice

The internal audit units of the national authorities can play an important role in ensuring that regulatory requirements are being met and provide a catalyst for sharing good practice and encouraging continuous improvement (e.g. SF, UK). Similarly, when carried out early in the programming period, the 5% inspection work at projects can also contribute to the confirmation of the quality and operation of a sound audit trail.

Weaknesses and recommendations

Weakness

In general, insufficient use is made of the work carried out by internal audit units within Member States.

Recommendations

Guidance could be produced for Member State internal audit units to use in ensuring that regulatory requirements are being met, and also serve to minimise the audit burden falling on those in receipt of structural fund support.

Administrative arrangements should be proportionate and sufficient to meet regulatory requirements but also need to have regard to their cost-effectiveness.

Part Three 5% Checks

Introduction

- 3.1. The requirements for the 5% sample checks on operations are set out in Articles 10 to 14 of Commission Regulation 438/2001. In particular Article 10 states that the checks carried out before the winding-up of each programme shall:
- cover at least 5% of the total eligible expenditure;
 - be based on a representative sample of approved projects;
 - seek to spread the implementation of the checks evenly over the period concerned; and
 - ensure an appropriate separation of tasks, between such checks and operational functions.
- 3.2. The objectives of the audit work were set so as to enable the SAIs to conclude on:
- the extent of compliance with the relevant articles of Commission Regulation 438/2001; and
 - the effectiveness with which this has been done.
- 3.3. The resulting report on the 5% check is in three parts: Objectives 1 – 4 dealing with issues at the programme level; Objectives 5 - 6 dealing with issues at the project level; and finally Objective 7 provides comments on any other issues relevant to the audit.

Audit Findings by Objectives

Objective 1: Quantitative overview of the 5% sample checks

Conclusion

Most SAIs concluded that the execution of the 5% checks in general complies with Commission Regulation 438/2001. Where this is not the case, the relevant authorities have taken steps to ensure that the required checks will be carried out by the end of the programming period. The independence of the organisations that carry out the 5% sample checks is fully guaranteed in most countries.

Findings

In most countries the start of the 5% checks has been relatively slow and often not evenly spread over the period to date. In most countries where the 5% checks were found to be lagging behind, the relevant bodies believe that steps in the right direction have been taken and that by the end of the programming period all the required checks will have been carried out.

In some countries there are variances in the proportion of the total programme subsidies incorporated in the 5% checks. In one or more programmes in these countries more than 5% - sometimes much more - of the total programme expenditures had been included in the checks. At the same time, in other programmes only a small proportion of the programme subsidies had been included in the checks, sometimes combined with delays in the execution of the checks.

In some countries the checks only included declarations of expenditure and excluded the required audit of the managing and control systems.

Sufficient safeguards have been built-in to guarantee the independence of the inspection teams.

In some countries more than 5% of the total expenditure was checked in order to compensate for the fact that the number of projects is small and therefore a representative statistical sample cannot be drawn.

Weaknesses and recommendations

Weaknesses

In general, the volumes of 5% checks carried out to date have not been sufficient to make a significant contribution to the development and improvement of the systems.

The regulations do not direct member states to carry out the checks over the lifetime of the programme, thus leaving the possibility for the checks to be completed at the end of the period in 2008. This, however, is too late to influence the performance of projects.

Recommendation

The new structural funds regulations (post 2006) should contain a legal obligation to spread the execution of the 5% checks more evenly over the programme period.

Objective 2: How was the selection carried out of projects to be included in the 5% checks?

Conclusion

In most countries the selection process for the projects to be included in the 5% checks conforms to the rules laid down in Article 10 of Commission Regulation 438/2001. In these countries a risk assessment and/or a representative sample were used to select the projects. In other countries the selection process can be improved.

Findings

In most countries, the selection of the projects for the 5% checks conforms to the rules laid down in Article 10 of Commission Regulation 438/2001. This means that a risk assessment was used in the selection and/or a representative sample of the projects was drawn.

In some countries the selection of the projects for the 5% check could be improved. In some of the selection processes, especially the risk assessments that form the basis for the process, improvements can be made, for example by making them more systematic against specified criteria.

For one programme it was reported that the selection process was not well documented.

On occasion the selection criteria used within managing authorities are not consistent. The Regulation allows for different selection methods; it was found that the interpretation of the Regulation rules was not always consistent between Directorates-General of the European Commission.

Good practice

Annual risk assessments and a formalised and systematic sample selection process were used (SF).

Weaknesses and Recommendations

Weakness

Not all countries complied with the requirement for both a risk assessment and a representative sample to be used in the selection process.

Recommendations

Risk assessments should be used more systematically when selecting projects for the 5% checks.

The European Commission should provide uniform interpretations of the European rules across the different Directorates-General.

Objective 3: Content of the checklist for the 5% checks

Conclusion

The checklists used for the 5% checks are generally in compliance with Commission Regulation 438/2001. In some countries the managing and control systems are not explicitly addressed in the checks.

Findings

In general the contents of the checklists used for carrying out the 5% checks are satisfactory and are in compliance with the requirements set out in article 11 of Commission Regulation 438/2001.

In one country, the checklist used for the system checks was considered to be almost too comprehensive, which reduced its usefulness.

Within some countries and programmes, there are inconsistencies in the contents of the checklists, against the set guidance. Whilst in others countries the checklists did not sufficiently cover the required checks of the management and control systems.

Good practice

Use of a standard checklist for the 5% checks helps ensure a consistent approach and report (UK).

Inspection reports include recommendations to the project, intermediate bodies, and the paying and managing authorities, as appropriate (UK).

Recommendation

The audit of the management and control systems should be given a higher priority, to detect flaws in the systems at an early stage of the programming period.

Objective 4: Have information requirements been met?

Conclusion

In most cases the information requirements of Article 13 have been met in terms of correctness and timeliness. However, in some cases the information could be more complete, more detailed, and more explicit regarding the outcome of the 5% checks and the way these checks were carried out.

Findings

The requirements of Article 13 of Commission Regulation 438/2001 indicate that each year the Member State should report on the application of Articles 10 to 12 and on the update of the management and control system. These requirements remain somewhat vague as to what exactly should be reported, and in how much detail, to the European Commission.

The Article 13 reports were usually submitted to the European Commission on time – i.e. before 30 June of each year - with two exceptions.

The information contained in these Article 13 reports was considered to be accurate. However, the reports could be more complete, giving more details and including a clear and explicit report on the way the checks were carried out. The information in one country focussed more on the quantitative outline of how much was checked rather than on the findings of these checks.

Good practice

The Audit Programme routinely includes follow-up on the results from previous audits (NL).

Recommendations

The Article 13 reports should contain detailed information on the 5% checks (findings, methods, coverage, etc.) in compliance with Annex 5 to the Commission Guideline on management and control systems.

In the regulations covering the post 2006 programme period, guidance on the production of the Article 13 reports should be more explicit and detailed in relation to the information required in respect of Article 10 to 12 issues.

Objective 5: Examination of the reports of the 5% checks

Conclusion

Most of the SAIs were satisfied with the quality of the audit reports, although in one case the formal reporting of the 5% checks was inadequately documented.

Findings

All SAIs have reviewed the reports produced by the 5% inspection teams. In general, the supporting files were well referenced and the results of the checks and basis of selection of projects are well documented. In one country the list of documents and invoices which had been the basis of the 5% checks was missing; hence the SAI was not in a position to follow the checking process in detail and to give recommendations on how to improve the quality of the checks.

Good practice

In some countries the inspection reports included an assessment of the progress of the project against agreed objectives.

Weaknesses and recommendations

Weakness

Inspection reports often focussed on financial information and provided little comment on the project's activities and on the progress in meeting objectives.

Recommendations

All reports should, as a minimum, contain the information demanded in Annex 5 to the Commission Guideline on management and control systems.

The basis of selection of projects for examination and the results of the checks carried out should be clearly documented.

Objective 6: Findings of the 5% checks

Conclusion

In most countries, the quality, contents and robustness of the 5% inspection reports were satisfactory.

Findings

Most SAIs found that the 5% check bodies had established good practice which enabled the managing authorities to act on the results of the checks for future work. Errors reported are based on individual and procedural shortcomings. Common errors were:

- missing or wrong time registration in educational projects (for attendants, consultants and instructors);
- VAT incorrectly taken as expenditure;
- payroll overheads and depreciation overstated;
- costs not correctly apportioned or attributed to the projects.

In one country some incorrect payments of EU contributions to private individuals were identified.

Good practice

Errors found as a result of the 5% checks are used to evaluate the effectiveness and coverage of the 5% checking programme.

A final beneficiary of an ESF programme receives from its internal control body complete information about irregularities through an IT administration system which allows to following them up (E).

Weaknesses and recommendations

Weakness

The existence of frequent errors suggested that projects did not always amend their internal control systems in response to shortcomings previously identified.

Recommendation

Errors found as a result of the 5% checks should be summarised and reported back to projects in order to help prevent errors being repeated.

Objective 7: Other relevant matters arising from the audit

Conclusion

The SAIs found that the interpretation of Structural Fund rules by the Commission was at times ambiguous or even contradictory. Furthermore, Member States expressed concern at the increasing bureaucracy in the implementation of the new provisions for the 2000 – 2006 Programme and felt that the associated resource costs were out of proportion to the EU's funding.

Findings

Some SAIs believe that they could advise the audited bodies how to avoid mistakes and to proceed better in future, partly by general recommendations, partly by specific guidance. Member States commented that the way in which the regulations are formulated by the Commission can lead to ambiguous or even contradictory interpretations; for example on the sampling and transaction testing methodology, and on the extrapolation of results.

Furthermore, they expressed concern at the increased bureaucracy in the implementation of the provisions for the 2000 – 2006 Programme, resulting in increased staff and other costs.

The timing of the 5% checks, particularly if carried out early during the programming period, does not necessarily provide assurance that the project will succeed.

Recommendations

The 5% checks should include an audit of the effectiveness of the existing systems of internal control, as required by article 10, sub article 1 of Commission Regulation 438/2001.

The Commission should provide guidance on the interpretation of Article 5 of Commission Regulation 438/2001 in respect of the examination of the management and control systems. This would help the managing authorities to improve their systems.

Annex A: Distribution of Structural Funds by Member States*

Distribution of Structural Funds by Member States represented in the Working Group for the period 2000-2006³ (in EUR million at 1999 prices)					
Member State	Objective 1	Objective 2	Objective 3	Fisheries Instrument (outside obj. 1 areas)	Total
Denmark	0	183	365	197	745
Finland	913	489	403	31	1.836
Germany	19.958	3.510	4.581	107	28.156
Netherlands	123	795	1.686	31	2.635
Italy	22.122	2.522	3.744	96	28.484
Portugal	19.029	0	0	0	19.029
Spain	38.096	2.651	2.140	200	43.087
Sweden	722	406	720	60	1.908
United Kingdom	6.251	4.695	4.568	121	15.635
Total	107.214	15.251	18.207	843	141.515

* Without Communities Initiatives, innovative measures and technical assistance.

³ Newsletter No. 65 of the „inforegio news“ published in June 1999 by the EC Directorate-General for Regional Policy and Cohesion (Document number CX-AB-99-006-EN-C)

Annex B: Coverage of the Audit

Funds covered:

Member State	ERDF	ESF	EAGGF	FIFG
Denmark		X		
Finland	X			
Germany		X		X
Netherlands	X		X	X
Italy	X	X	X	X
Portugal	X	X	X	
Spain	X	X	X	
Sweden	X	X		
United Kingdom	X	X		

Projects covered:

(Project files checked / project questionnaires / or project visits)

Projects					
Member State	ERDF	ESF	EAGGF	FIFG	Total
Denmark		45			45
Finland	4				4
Germany		11		2	13
Netherlands	41		2	2	45
Italy	6	4	2	5	17
Portugal	10	6			16
Spain	22	1	7		30
Sweden	18	6			24
United Kingdom	20	20			40

Objectives covered (number of programmes):

Objectives			
Member State	1	2	3
Denmark			1
Finland	2		
Germany	6		1
Netherlands	1	2	
Italy	3	1	1
Portugal	1		
Spain	3		1
Sweden		1	1
United Kingdom	2	7	7

Annex C: Risk factors

The 5 % inspection body must base the control of each Programme on a 5 % sample selection of the total Fund-expenditure according to the following criteria in Commission Regulation 438/2001:

- Different project types and grant amounts
- Risk assessment
- Material intermediate bodies and final beneficiaries must be checked at least once during the programming period.

To create a more comprehensive sample selection for the control of the Programme the SAIs recommend that the 5 % inspection body consider the following risk factors:

- Changing project managers
- Project managing divided between more partners
- Previous experience with individual project managers
- Small scale projects with non sufficient segregation between internal control functions and any other business
- Use of distribution scales for overhead costs
- Project characteristics complicate physical control (e.g. participation in web-based training)
- High salary costs for project staff
- 5 % inspection body's previous experience with this type of project
- Project dependence on project manager's other activities
- Press coverage
- Payment request problems
- High consultancy fees
- Type of assistance.

Typical errors found in 5 % checks:

The SAIs recommend that the 5 % inspection body analyses the findings of the controls and include any additional risk factors in the next sample selection. The SAIs have found the following risk factors based on finalised controls carried out by the 5 % inspection bodies:

- Problems concerning time registration for participants in educational projects, including non-attendance policy
- Lack of internal control when records are entered in the shared grant administration system
- Lack of documentation of internal salaries
- Lack of documentation of other co-financing
- Lack of time registration for consultants and instructors
- No reconciliation of local bookkeeping to records in the shared grant administration system

- Lack of documentation for distribution scales for overhead costs
- Problems with estimation of depreciation rates
- Problems involving IT security concerning the shared grant administration system
- Lack of procedures for dealing with irregularities
- Non-compliance with tendering regulations

Annex D: List of Abbreviations

EAGGF: European Agricultural Guidance and Guarantee Fund

EC: European Commission (Commission)

ECA: European Court of Auditors

ERDF: European Regional Development Fund

ESF: European Social Fund

EU: European Union

FAQs: Frequently Asked Questions

FIFG: Financial Instrument for Fisheries Guidance

IT: Information Technology

OJ: Official Journal

SAI: Supreme Audit Institution

VAT: Value Added Tax

Countries

D: Germany

DK: Denmark

E: Spain

I: Italy

NL: Netherlands

P: Portugal

S: Sweden

SF: Finland

UK: United Kingdom

Appendix: Audit Plan

(in separate edition)