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THE FINANCIAL MANAGEMENT, CONTROL AND AUDIT OF EU COHESION POLICY: CONTRASTING VIEWS ON CHALLENGES, IDIOSYNCRASIES AND THE WAY AHEAD

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PREFACE

The research for this paper was undertaken in preparation for the 25th IQ-Net meeting held in Attikí, Greece, on 19-21 November 2008. The paper was written by Sara Davies, Frederike Gross and Laura Polverari.

This paper is the product of desk research and fieldwork visits during Summer/Autumn 2008 to national and regional authorities in EU Member States (notably partners in the IQ-Net Consortium). The field research team comprised:

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Austria

- State Government of Niederösterreich, Economic and Tourism Department
- State Government of Steiermark, Economic Policy Department

Belgium

- Agency for the Economy of Vlaanderen, Europe Economy

Czech Republic

- Ministry for Regional Development

Denmark

- Danish Enterprise and Construction Authority

Finland

- Alliance of Länsi-Suomi

- Ministry of Employment and the Economy

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- Sachsen-Anhalt, Ministry of Finance

Greece
- CSF Management Organisation Unit, Ministry of Economy and Finance

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- Ministry of Economic Development and Institute for Industrial Promotion (IPI)

Poland
- Śląskie Voivodeship (Marshal's Office)

Portugal
- Financial Institute for Regional Development (IFDR)

Spain
- País Vasco, Provincial Council of Bizkaia, Department of Economy and Finance

Slovenia
- Government Office for Local Self-Government and Regional Policy, EU Cohesion Policy Department

Sweden
- NUTEK, Swedish Agency for Economic and Regional Growth

UK
- Department of Communities and Local Government
- ONE NorthEast
- Scottish Government
- Welsh European Funding Office

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It should be noted that the content and conclusions of this paper do not necessarily represent the views of individual members of the IQ-Net Consortium.

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EXECUTIVE SUMMARY

This paper examines ongoing challenges in the financial management, control and audit of EU Cohesion policy, as well as recent steps taken by EU authorities to resolve these issues. It also explores the experiences of authorities in fifteen Member States in designing and implementing financial management, control and audit systems in the 2007-13 period, drawing on interviews undertaken with a range of authorities in fifteen Member States. Further, the paper provides an overview of the disparate, and often conflicting, views of authorities at EU, Member State and regional levels of the changes needed and the challenges faced. Although not selected as a representative sample, the range of EU, national and regional authorities interviewed for this research reflects experiences from most parts of the EU and encompasses programmes accounting for a sizeable share of total Structural Funds expenditure in 2007-13.

The increasing emphasis on financial management, control and audit in EU Cohesion policy in recent years can be related to broader concerns among policy-makers over the efficiency and accountability of public sector activity. These concerns and associated reforms have been analysed by the 'New Public Management' (NPM) literature, which identifies a number of common trends in different EU Member States and other countries. However, the degree and focus of reform introduced have varied in intensity and scope due, for example, to domestic institutional and political factors.

The Structural Funds approach to financial management, control and audit has shifted markedly since the 1990s. EU rules and procedures have become stricter, and complex systems of checks and balances have been set up with the aim of verifying that these rules are respected. There has been an expansion in the number of authorities and staff involved in this work, both within Member States and at EU level. Nevertheless, there remains considerable tension over the costs and benefits of the Structural Funds approach to financial management, control and audit, and over the appropriate roles of EU and Member State authorities in controlling and auditing EU co-financed expenditure.

A number of steps have been taken by EU authorities since the mid 2000s with the aim of addressing criticisms of the quality of Structural Funds financial control and audit, the duplication of work by Member State and EU officials, and the proportionality of procedures in terms of administrative burden and cost. Nevertheless, a number of challenges remain. These include the persistently high level of financial irregularities; the burden of financial control and audit activities; and difficulties in appropriately allocating tasks between EU and Member State authorities. EU authorities have responded by developing an integrated framework for budgetary control; by improving the Commission's own systems for financial control and audit; by taking steps to enhance coordination between audit authorities at

different levels; by emphasising the responsibilities of Member State authorities; and by endeavouring to re-define the tolerable risk of error.

Various EU institutions are responsible for tasks which contribute to the control of EU budget expenditure and revenue, notably the European Court of Auditors, the Council, the Parliament and the Commission. There are EU-level mechanisms which aim to ensure that all financial operations under the EU budget are legal and justified; that all expenditure and revenue collection procedures are undertaken effectively and efficiently; and that all procedures respect the principles of sound financial management.

Although there is broad agreement among EU authorities of the need to continue to improve the management, control and audit of the EU budget, there is a lack of consensus over the level of ongoing financial irregularities. While the Court of Auditors and the Parliament criticise the Commission's approach to the control and audit of Cohesion policy, the Commission disputes some of the Court's findings and interpretations of audit data. All EU authorities agree that Cohesion policy is characterised by a relatively high level of risk of error due, for example, to the multiplicity of organisations, systems, operations and beneficiaries involved in implementation; the multiplicity of types of project and programme; and the detailed eligibility requirements at Community and Member State levels which may increase complexity and risk of misinterpretation.

Member States are taking different approaches to the implementation of the 2007-13 regulations and guidelines in the field of financial management, control and audit. Differences are seen, for example, in terms of the allocation of responsibilities among key Structural Funds entities (Managing Authority, Certifying Authority, Audit Authority, and Intermediate Bodies), as well as in approaches to capacity building, staffing and electronic data monitoring systems.

Member States agree that effective systems are needed for the financial management, control and audit of Structural Funds resources, and also note some positive effects of the Structural Funds rules. Nevertheless, they also raise a number of criticisms relating, for example, to the administrative burden of Structural Funds programmes, and the need for a better allocation of responsibilities between Member State and EU levels. The Member State authorities interviewed suggested that action is needed in the following areas:

- To build capacity at all levels, from the Commission to the final beneficiaries;
- To provide timely, clear and definitive rules and guidance;
- To ensure greater clarity and better communication;
- To improve coordination within the Commission;
- To increase proportionality at programme and project levels;
- To implement genuine shared management; and
- To re-focus efforts on fraud rather than on formal irregularities.

THE FINANCIAL MANAGEMENT, CONTROL AND AUDIT OF EU COHESION POLICY: CONTRASTING VIEWS ON CHALLENGES, IDIOSYNCRASIES AND THE WAY AHEAD

1. INTRODUCTION

One of the major changes in Cohesion policy since the 1990s is the increased focus on financial management, control and audit. This has led to the expansion of rules and guidelines and the introduction of more complex systems of checks and balances aimed at verifying expenditure. The number of authorities and staff involved in this work has also increased, both within Member States and at EU level. Nevertheless, there are contrasting views of the costs and benefits of the Cohesion policy approach to financial management, control and audit, and over the appropriate role of EU and Member State authorities in controlling and auditing EU co-financed expenditure.

This paper describes the recent steps taken by EU authorities to improve systems and procedures in this area, and also explores the different views held by EU authorities (including the Parliament and the Court of Auditors as well as the Commission). In addition, the paper provides a summary of the experiences and views of authorities at national and regional levels in relation to financial management, control and audit. It draws on a mix of desk research and interviews with staff working on the implementation of Structural Funds programmes. The desk-based research focused on EU-level and programme documents, including systems descriptions and audit strategies where these were available. The interviews were undertaken in fifteen Member States with a range of Managing Authorities, Intermediate Bodies, Certifying Authorities, Audit Authorities, programme secretariats and national coordination bodies. In addition, interviews were carried out with audit staff in DG Regional Policy and DG Employment. Although not selected as a representative sample, the range of national and regional authorities interviewed for this research reflects experiences from most parts of the EU and encompasses programmes accounting for a sizeable share of total Structural Funds expenditure in 2007-13.

The next section sets the increased EU Cohesion policy focus on financial management, control and audit in the context of a more general endeavour to improve the efficiency and accountability of public sector activity. The third section then examines the evolution of financial management, control and audit in Cohesion policy since the 1990s, and explores the main challenges and responses at the beginning of the 2007-13 period. The fourth section outlines the roles and views of the various EU-level authorities involved in this field. The fifth and sixth sections focus on the implementation of Structural Funds programmes in selected Member States, and respectively provide a description of the different approaches taken to the organisation of financial management, control and audit, and an overview of key tasks of the Managing, Certifying and Audit Authorities. The seventh section summarises the views of the programme managers interviewed, and the final section draws some conclusions and poses a series of questions for discussion.

2. THE SHIFT TOWARDS NEW PUBLIC MANAGEMENT AND GOOD GOVERNANCE

The increasing emphasis on efficient financial management, control and audit in EU Cohesion policy reflects broader concerns related to the efficiency and cost of public sector activity which have emerged in the past three decades. These concerns and associated reforms have been analysed by the 'New Public Management' (NPM) literature, which identifies a number of common trends in different countries.[1] However, the changes and reforms introduced in Member States' systems have varied in intensity and scope, depending on domestic problems and history, as well as the degree of pressure from international organisations.[2]

The introduction of efficiency-oriented administrative reforms is often traced back to the 1980s, as part of broader government efforts in the UK, New Zealand, Australia and North America to restrain and increase the efficiency of public spending.[3] The salient character of these reforms includes:[4]

- the privatisation of civil service functions;
- the liberalisation of services and goods provision;
- the decentralisation or deconcentration of functions to sub-national bodies;
- the introduction to the public sector of management techniques and ideas derived from the private sector, such as subcontracting and competitive bidding systems and the pursuit of collaborative endeavours with the private sector, for instance in the form of public-private partnership;

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[1] C. Hood (1991) '*A Public Management for All Seasons'* in *Public Administration*, 69, 13-19.

[2] I. S. Rubin and J. Kelly '*Budgeting and Accounting Reforms'* in E. Ferlie, L. E. Jr Lynn and C. Pollitt *The Oxford Handbook of Public Management* (Oxford University Press, Oxford, 2007 Paperback); C. Pollitt and Bouckaert C., *Public Management Reform: A Comparative Analysis* (Oxford University Press, Oxford, Second Edition, 2004).

[3] P. C. Light (1997) *The Tides of Reform – Making Government Work 1945-1995*, Yale University Press, New Haven, 1997; C. Talbot (1999) Public Performance – towards a new model?, *Public Policy and Administration*, 14(3), 15-34; M. S. Levitt and M. A. S. Joyce (1987) *The Growth and Efficiency of Public Spending*, Cambridge University Press, Cambridge.; L. E. Jr. Lynn, '*Public Management. A concise history of the field'* in Ferlie E, Lynn L E Jr. and Pollitt C, *op. cit.* 27-50; B. A. Radin, '*The Instruments of Intergovernmental Management',* in Peters G and Pierre J (eds.), *The Handbook of Public Administration* (Sage, London, 2007, 365-376). D. Tarschys, *The Enigma of European Added Value: Setting Priorities for the European Union* (SIEPS, Stockholm, 2005).

[4] E. Kolthoff, L. Huberts and H. Van Den Heuvel (2007) '*The Ethics of New Public Management: is Integrity at Stake?', Public Administration Quarterly*, Winter 2007, 399-439; C. Pollitt and G. Bouckaert (2004) *op. cit.*; D. J. Savoie, *Thatcher, Reagan and Mulroney: In Search of a New Bureaucracy* (University of Toronto Press, Toronto, 1994); Kustec-Lipicer S and Kovač P (2008) *Quality of Governance Through the Lenses of Administrative Reform in the Post-Socialist Circumstances*, Paper presented at the European Consortium for Political Research, Workshop 11 "*Administrative Reform, Democratic Governance, and the Quality of Government",* Rennes, 11-16 April 2008; D. Tarschys, *op. cit.*

- the measurement of the performance of public sector bodies, for example through regular performance assessments, and the establishment of *ad hoc* bodies to oversee efficiency improvements and identify opportunities for saving;

- the modernisation, reorganisation, rationalisation and performance management of the civil service, through quasi-business contractual arrangements, the introduction of performance targets and indicators, a shift from direct authority to indirect control, and the use of external temporary workers; and,

- strategic planning, notably output budgeting, based on the use of performance information and feedback on results.

Approaches to public sector reform evolved in the 1990s, not least in response to growing public dissatisfaction with the market's failure to deliver efficient and high-quality public services, leading to the adoption of service quality improvement schemes and quality management, to increasing emphasis on notions of service and good governance, and to calls for a stronger emphasis on the public administration's capacity to respond to collective public interest.[5]

The focus on performance management and public sector efficiency has not been confined to Anglophone countries but has also emerged in other European countries since the 1990s. In the EU15, these changes were prompted by political and financial domestic pressures and by the need to meet Maastricht criteria for Economic and Monetary Union. Country-specific responses have varied, both in scope and timetable, depending on legal systems and administrative traditions.[6] One classification of different country responses has found that the Nordic EU Member States (particularly Finland and Sweden) were relatively open, albeit selectively, to NPM ideas, especially those relating to performance management rather than those on privatisation.[7] In contrast, 'Napoleonic' systems are seen to have been less receptive to change, although France has introduced some relevant administrative reforms in recent decades, and Italy has blended NPM ideas with pre-existing, and not necessarily coherent, administrative approaches. 'Continental' countries, such as Belgium and Germany, have also undertaken reforms, but incrementally and via a process of adaptation to national norms, values and systems.

The NPM reform agenda also appeared in Central Europe in the 1990s, as part of the reconfiguration of the public sector after the collapse of the Iron Curtain.[8] The establishment of functioning market economies entailed a fundamental division between the State and the broader economy, leading to systemic changes which included reforms to the public administration. Reform was shaped and arguably accelerated by accession to the

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[5] Kustec-Lipicer and Kovač (2008) *op. cit.*; P. Goldschmidt, M. Darul'ová, T. Niculescu and A. Stemberger (eds.), *Reference Guide for Horizontal Integration* (NISPAcee, Bratislava, 2005); R. B. Denhardt and J. Vinzant Denhardt, *'The New Public Service: Serving Rather than Steering' (2000), Public Administration Review,* 60(6), 549-59.

[6] Kolthoff et al. (2007*) op. cit.* p.406.

[7] Pollitt and Bouckaert (2004) *op. cit.*

[8] Kustec-Lipicer and Kovač (2008) *op. cit.* p.4.

EU and the need to conform to the *acquis*. A recent World Bank report identifies two waves of public sector reform in the new Member States: a first wave associated with accession, and a second wave driven by participation in the EU and the implementation of EU policies, particularly Cohesion policy.[9]

Progress in the new Member States has been mixed and, in many cases, reforms are still underway, including ongoing institutional reorganisation and decentralisation; new financial management, reporting and IT systems; and training programmes and capacity building activities.[10] Overall, the appeal of NPM ideas in the new Member States has been relatively high but, as for the EU15, the impetus and breadth of reforms has varied across the EU12, depending on domestic factors such as perceptions of the role of the state and the relationship between the administrative and political spheres. In Slovenia[11], the public administration has drawn extensively on ideas associated with NPM, but administrative reform has been more limited in Poland and the Czech Republic, although the Czech Ministry of Finance recently set up a working group on public sector reform and NPM.

Issues relating to financial management, control and audit have been central to public administration reforms undertaken in the past 20-30 years in virtually all EU Member States. For instance, the transition from direct State authority to indirect control via sub-national authorities or non-governmental agencies has entailed an increased emphasis on financial control and audit (see **Box 1**).[12] Similarly, the move towards private sector working methods has in some countries led to a shift towards the accrual budgeting and accounting systems traditionally used by businesses, as opposed to the cash-based systems typically seen in the public sector.[13] More generally, financial management, control and audit are evolving from purely 'financial' tasks, to include more general forms of support for decision-making, accountability, quality control and performance assessment - functions that are instrumental to the capacity of public administrations to deliver services democratically, efficiently and effectively.[14]

Ideas associated with NPM have also led to reforms in EU policy-making, not only in terms of the functioning of the EU institutions themselves (notably the Commission) but also in the requirements placed on Member States. In this context, EU regulations for

[9] World Bank (2006) *EU-8 Administrative Capacity in the New Member States: The Limits of Innovation?*, Washington D.C. pp.4-5.

[10] I. McMaster and K. Mirwaldt (2008) *'Policy Development in the New Member States'*, *Regional Policy Developments in the New Member States and Norway: Country Reviews 2007-2008,* EoRPA Paper 08/2 (European Policies Research Centre, Glasgow, 2008, 1-26); T. Verheijen *Administrative Capacity in the New EU Member States. The Limits of Innovation?* (The World Bank, Washington, 2007).

[11] Kustec-Lipicer and Kovač *op. cit.*; Verheijen *op. cit*.

[12] Kolthoff et al 2007 *op. cit.*

[13] L. Kok 'Accrual Budgeting in a Comparative Perspective', in G. Peters and J. Pierre (eds.), *The Handbook of Public Administration*, (Sage, London, 2007, 258-265); Rubin and Kelly *op. cit.*

[14] Kolthoff et al 2007 *op. cit.;* Rubin and Kelly 2007 *op. cit.*

implementing Cohesion policy have acted as a catalyst for the development of more systematic and performance-oriented financial management across the EU.[15]

Box 1: Scotland's 'Single Outcome Agreements'

One aspect of recent public sector reforms is the delegation of tasks from the central State to sub-national authorities or to other public, quasi-public or private agencies. This raises the so-called 'principal-agent' problem, whereby a central authority faces difficulties in ensuring that its agents undertake tasks effectively and efficiently.[16] While Cohesion policy aims mainly to address these problems by reducing information asymmetries via financial monitoring, control and audit, an alternative solution is to align more closely the interests of the principal and the agent.

The Scottish Government is currently pursuing this alternative approach via Single Outcome Agreements between the Government and each of Scotland's 32 local authorities, which are responsible for a wide range of policy fields including policing, community development, education, transport and environmental protection. Key aspects of the Agreements are that:

1. The Government significantly reduces the extent of ring-fencing of funding for specific interventions, and mainly provides a block of funding to local authorities.
2. The local authorities will (for the first time) be able to retain any efficiency savings.
3. A simplified reporting system is set up, whereby each local authority submits a single annual report, including information on agreed, indicator-based targets.
4. The Government guarantees the amount of funding available until 2011, and also that no reform of local authorities will be undertaken before 2011.

[15] OECD (2008) Report on indicators for regional policy, Paris.

[16] J. Stiglitz (1987) *Principal and agent, The New Palgrave: A Dictionary of Economics*, Vol. 3, pp.966-71.

3. FINANCIAL MANAGEMENT, CONTROL AND AUDIT IN EU COHESION POLICY

3.1 The evolution of financial management, control and audit in EU Cohesion policy

The Structural Funds approach to financial management, control and audit has shifted markedly since the 1990s. The need for effective and efficient control and audit systems has become a major political issue in relation to the Structural Funds, and can now be seen as one of three overarching goals, alongside the need to target resources on projects that bring clear socio-economic benefits, and the need to ensure that funding is committed and spent in a timely way. The political emphasis on control and audit has led to more stringent EU rules and procedures, as well as complex systems of checks and balances aimed at verifying that these rules are respected. There has been an expansion in the number of authorities and staff involved in this work, both within Member States and at EU level. Nevertheless, there remains considerable tension over the costs and benefits of the Structural Funds approach to financial management, control and audit, and over the appropriate roles of EU and Member State authorities in controlling and auditing EU co-financed expenditure.

In the 1989-93 and 1994-99 periods, Structural Funds regulations included rules on financial management, control and audit, but the implementation of these rules varied between Member States. Programmes' financial management and monitoring systems were often relatively unsophisticated compared to those in place today. Financial control and audit were mainly undertaken by domestic authorities, so that the approaches adopted and the quality of checks varied between Member States. Programmes were audited by Commission staff and the European Court of Auditors, but the number of checks was limited due to the modest numbers of staff employed. The country desks in the Commission's Fund DGs were mainly responsible for dealing with problems relating to, for example, project eligibility or the misuse of funds, and there was generally reluctance at a political level to suspend payments if irregularities arose. Both the European Court of Auditors and the European Parliament criticised aspects of Structural Funds financial management, control and audit. Nevertheless, the Parliament voted to discharge (or sign off on) the EU budget in every year except 1984.

The main stimulus for a change in approach came in 1998, with the emergence of financial irregularities in some European Commission activities, the refusal of the Parliament to discharge the Community budget for 1996, and the subsequent resignation of the Santer Commission in March 1999. This led to a reform package under Commission President Prodi, which included the creation of the European Anti-Fraud Office (OLAF) in 1999 and the Internal Audit Service (IAS) in 2001, as well as the strengthening of financial control and audit functions in DGs responsible for major components of the EU budget. It also led to the adoption in 2002 of a new Financial Regulation setting out broad principles and basic rules relating to the EU budget (with amendments following in 2005, 2006 and 2007).[17]

These reforms influenced the shape of EU Structural Funds regulations for the 2000-06 period, not least the adoption of Regulation (438/2001) on management and control systems. In addition, the Fund DGs recruited further staff to work on financial control and audit in units separate from the country desks, with DG REGIO, for example, first establishing a unit focused solely on audit in the year 2000. The increased codification and stringency of the EU approach to financial management, control and audit, however, led Member States to criticise the administrative burden of Structural Funds programmes and to call for greater simplification and proportionality in implementation. In the same period, there was more vocal criticism from the European Court of Auditors and the European Parliament, with the Court's reports showing significant levels of financial irregularities in the implementation of the Cohesion policy budget.

3.2 Cohesion policy in 2007-13

Further steps were taken by EU authorities in relation to Structural Funds financial management, control and audit at the end of the 2000-06 period and the beginning of 2007-13. These steps aimed to address various criticisms relating to the quality of Structural Funds financial control and audit, the duplication of work by Member State and EU officials, and the proportionality of procedures in terms of administrative burden and cost. Nevertheless, there are still ongoing debates over important aspects of the Structural Funds approach to financial management, control and audit.

3.2.1 The core challenges

(i) Persistently high levels of financial irregularities

The European Court of Auditors and the European Parliament continue to criticise Structural Funds financial control and audit systems, arguing that implementation is inadequate and that the level of financial irregularities remains unacceptably high.[18] The Court has not given a positive Statement of Assurance (*Déclaration d'Assurance*, DAS) on the EU budget since the DAS was introduced in 1995. Its annual reports state that the EU accounts are reliable, but note high levels of irregularities in transactions concerning receipts, commitments and payments.[19] Similarly, the Parliament has voiced significant criticisms of the implementation of the EU budget by the Commission and the Member States, although it has decided to discharge the budget in each year except 1984 and 1998.

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[17] European Council (2002*) No. 1605 of 25.06.02 on the Financial Regulation applicable to the general budget of the European Communities, Official Journal L248*, 16.09.2002 (amended by Council Regulation No. 1995/2006 of 13 December 2006, Official Journal L390; and by Council Regulation No. 1525/2007 of 17 December 2007, Official Journal L343).

[18] European Court of Auditors (2007) *Annual report on the implementation of the budget concerning the financial year 2006, Luxembourg.*

[19] European Court of Auditors (2007) *op. cit.*

The Commission agrees that the current level of financial irregularities is too high but argues that the Court's methodology over-estimates the actual error level, not least because its 'snapshot' approach does not allow for the fact that many of the errors found in projects would be detected by Member States' financial control and audit systems during the programme period.[20] Similarly, there is some disagreement between the Court and the Commission over the classification of different types of error and the interpretation of audit findings (see Sections 4.1 and 4.3).

Box 2: What is a 'financial irregularity'?

Most financial irregularities are the result of formal or administrative errors rather than fraud. Some observers argue that the Court should report separately on the two categories of 'formal financial irregularities' and 'fraud'.[21] However, it may be difficult to detect whether an error is formal or fraudulent; for example, if a final beneficiary claims for ineligible categories of expenditure, this may or may not be a genuine mistake. Similarly, if a document is missing, this may or may not be because the beneficiary has something to hide. It is usually difficult to prove that action involves fraud, as this is seen to imply that the error is intentional, and that it benefits the person making the error.

The European Court of Auditors defines five categories of error which are related to financial irregularities:[22]

1. Eligibility error: a reimbursement does not comply with an eligibility rule;
2. Occurrence error: a reimbursement includes a cost which is not supported by an invoice or similar document;
3. Accuracy error: a reimbursement for an incorrect amount;
4. Multiple error: a combination of two or more of the first three types of error;
5. Compliance error: mostly mistakes in contracting and failures to meet publicity requirements.

The Court states that the first four categories necessarily imply that funds have been wrongly reimbursed, but that many compliance errors do not affect the reimbursement of project costs.

(ii) The administrative burden of financial control and audit

The pressure on the Commission and Member States to improve their systems for managing, controlling and auditing EU resources has led to a significant expansion in the administrative cost and burden associated with Cohesion policy interventions. Simple indicators - such as the number of staff employed on these activities in the Commission and Member States, or the level of detail in the Structural Funds regulations - illustrate the extent to which these activities have expanded since the late 1990s. For example, before 2000, DG Regional Policy had a single unit of 30 people working on all aspects relating to financial management, control and audit, but now it has almost 60 qualified auditors working solely on audit.

[20] European Court of Auditors (2007) *op. cit.*

[21] UK House of Lords (2006) *Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals,* Fiftieth report of the Select Committee on European Union, London.

[22] European Court of Auditors (2007) *op. cit.*

Questions have been raised over the level of prescription and detail which EU authorities require, especially as Cohesion policy interventions must also conform to the requirements of Member States' own financial management, control and audit systems. The administrative burden also raises issues of cost, especially in smaller programmes where the additional cost of administering Structural Funds programmes and projects may account for a relatively high percentage of a Member State's receipts from the EU budget.

An additional concern is the effect of this administrative burden on programme design, project selection and financial flows.[23] It may discourage administrators from allocating resources to untried types of project or to beneficiaries which have not previously dealt successfully with EU funding rules. Similarly, it may slow down financial implementation at the level of projects, intermediate bodies and managing authorities, and thus reduce progress towards n+2 goals on the flow of funding.

Although some steps have been introduced in 2007-13 with the aim of reducing the administrative burden in smaller programmes, in line with the principle of proportionality, their effect is limited. For example, the 2007-13 regulations state that Member States do not need to provide an audit strategy for programmes with total eligible public spending of below €750 million and an EU co-financing rate of below 40 percent (Reg. 1083/2006, Art. 74). However, relatively few programmes fall into this category.

(iii) Allocating tasks between EU authorities and Member States

Various challenges associated with the management and control of Structural Funds resources are due to the complexity of a system which involves multiple authorities at EU, Member State and sub-national levels. Although the Treaty allocates formal responsibility for budgetary management to the Commission, it also emphasises its commitment to the principles of conferral, subsidiarity and proportionality (see Box 3). Moreover, the Member States are responsible for implementing over 80 percent of the EU budget, including almost all Cohesion policy resources.

[23] S. Rafalzik (2008) *Challenges for the future, proposals and solutions: the perspective of an Audit Authority,* Presentation by the Head of Austria's Audit Authority to the Cohesion Policy Open Days, Brussels, 9 October 2008.

Box 3: The Treaty and the Financial Regulation

Article 317 of the Treaty on the Functioning of the European Union (Article 274 of the Treaty establishing the European Community) states: "The Commission shall implement the budget […] on its own responsibility and within the limits of the appropriations, having regard to the principles of sound financial management. The Member States shall cooperate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management."[24]

Article 5 of the Treaty on European Union states: "The limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality. […] Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

Article 53b of the Financial Regulation[25] states: "Where the Commission implements the budget by shared management, implementation tasks shall be delegated to Member States. […T]he Member States […] shall in particular:

"(a) satisfy themselves that actions financed from the budget are actually carried out and to ensure that they are implemented correctly;

"(b) prevent and deal with irregularities and fraud;

"(c) recover funds wrongly paid or incorrectly used or funds lost as a result of irregularities or errors;

"(d) ensure, by means of relevant sector-specific regulations […] adequate annual ex post publication of beneficiaries of funds deriving from the budget.

[…T]he Member States shall conduct checks and shall put in place an effective and efficient internal control system […]. They shall bring legal proceedings as necessary and appropriate.

"Member States shall produce an annual summary at the appropriate national level of the available audits and declarations.

"[Moreover] the Commission shall apply clearance-of-accounts procedures or financial correction mechanisms which enable it to assume final responsibility for the implementation of the budget".

Cohesion policy is classified as an area of 'shared management', whereby the Commission retains final budgetary responsibility but the Member States are responsible for most implementation tasks. The Commission has published a Communication which provides a legal interpretation of the responsibilities of the Commission and the Member States in the context of the shared management of Cohesion policy.[26] The Commission's main focus is seen to be on "evaluating management and control systems and on the procedural and management weaknesses identified by risk analysis, without giving up its right to inspect individual operations where necessary". In turn, the Member States are obliged to ensure that an independent body certifies the quality of management and control systems before the programmes begin; to provide an annual audit report on expenditure and management and control systems; and to deliver a declaration of the validity of expenditure at programme closure. This approach is further codified in the Structural Funds regulations for the 2007-13 period.

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[24] European Union (2008*) Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union,* Official Journal of the European Communities C115/01, 09 May 2008.

[25] European Council (2002) *op. cit.*

[26] European Commission (2004) *Communication on the respective responsibilities of the Member States and the Commission in the shared management of the Structural Funds and the Cohesion Fund: Current situation and outlook for the new programming period after 2006*, Brussels, 06.09.2004.

Despite these efforts to define a solution in terms of 'shared management, the problem remains of how the Commission can receive sufficient assurance that the Member States are managing EU funds in accordance with EU rules and broader principles of sound financial management, without over-burdening the Member States or duplicating their work.

3.2.2 EU authorities' responses to ongoing challenges

(i) An integrated framework for budgetary control

At the centre of the EU authorities' response to ongoing difficulties in relation to the control and audit of the EU budget is the Commission's 2006 'Action plan towards an integrated internal control framework.[27] The plan was developed from a Commission 'roadmap' published in 2005, which in turn was drafted in response to the European Court of Auditors' 2004 proposal that the EU should adopt a 'Community internal control framework'.[28] The four core themes of the action plan are: simplification and common control principles; management declarations and audit assurance; single audit approach: sharing results and prioritising cost-benefit analysis; and gaps specific to particular elements of the EU budget. The Annual Activity Reports of relevant Commission DGs (including DG Employment and DG Regional Policy) provide information on work undertaken to achieve the key goals defined in the action plan.

Box 4: The Commission's action plan towards an integrated internal control framework

The plan sets out the following series of actions, with defined tasks and deadlines:

1. Simplification review of proposed 2007-13 legislation;
2. Integrate common internal control principles in the proposal for the revised Financial Regulation;
3. Establish and harmonise the presentation of control strategies and evidence providing reasonable assurance;
4. Initiate inter-institutional dialogue on risks to be tolerated in the underlying transactions;
5. Promote operational level management declarations and synthesis reports at national level;
6. Examine the utility of management declarations outside shared and indirect centralised management mode (e.g. in EU external and internal policies);
7. Promote best practices for increasing the cost-benefit of audits at project level;
8. Facilitate additional assurance from Supreme Audit Institutions;
9. Construct effective tools for sharing audit and control results and promote the single audit approach;
10. Make an initial estimate and analysis of the costs of controls;
11. Initiate pilot projects on evaluating benefits;
12. Address the gaps identified by sectoral Commission DGs;
13. Analyse the controls under shared management (in particular Structural Funds) at regional level and the value of existing statements;
14. Provide greater guidance for Structural Funds on managing the risk of error;
15. Promote the 'Contracts of Confidence' initiative for Structural Funds;
16. Establish common guidelines per policy family.

[27] European Commission (2006) *Commission Action Plan towards and Integrated Internal Control Framework. Commission Communication,* 17 January 2006, Brussels.

[28] European Court of Auditors (2004) Opinion on the 'single audit' model (and a proposal for a Community internal control framework), Official Journal C107, 30.04.2004.

(ii) Improving the Commission's approach to financial control and audit

Many of the Court's criticisms of EU budgetary control have focused on various aspects of the Commission's approach. For example, the Court's Annual Report for the financial year 2006 found that:

- there was a high level of errors in expenditure declared by the Member States and reimbursed by the Commission;
- the Member States' management and control systems were ineffective or only moderately effective;
- the Commission's systems for addressing these weaknesses were only moderately effective.

In response, the Commission published an action plan in 2008 aimed at improving its supervision of Member States' financial management, control and audit systems; enhancing the impact of its audit activity; facilitating effective reporting on financial corrections and recoveries; and ensuring timely action on the suspension of payments and financial corrections.[29] Since March 2008, the Commission has reported on a quarterly basis to the Parliament on progress towards meeting specific targets related to these goals.

Box 5: The action plan to strengthen the Commission's supervisory role

The Commission action plan aimed at improving supervision of Member States management and control systems sets out actions aimed at:

- Implementing the Structural Actions joint audit strategy for 2000-06;
- Implementing the Action Plan towards an Integrated Internal Control Framework;
- Preventing problems in relation to the closure of 2000-06 programmes and projects;
- Preventing problems in the 2007-13 period;
- Improving primary controls at national level;
- Improving reporting on financial corrections by Member States;
- Improving reporting by the Commission on the impact of audit activity;
- Increasing the impact of Commission audit activity;
- Improving the assurance provided by DGs' Annual Activity Reports;
- Maximising the value of annual summaries under Article 53 of the Financial Regulation.

Some aspects of the Structural Funds regulations for the 2007-13 period provide greater scope for the Commission to insist that Member States implement changes in their financial control and audit systems, compared to previous periods. For example, although managing authorities were obliged to present a description of management and control systems to the Commission in 2000-06 (Reg. 1260/1999, Article 38b), the Commission was not able to require changes if its staff were dissatisfied with the information provided. This was largely because these descriptions were generally delivered to the Commission as part of the programme complements, and thus after programmes had been approved. In contrast, in

[29] European Commission (2008) *Communication on an action plan to strengthen the Commission's supervisory role under shared management of structural actions*, Brussels, 19.02.2008.

2007-13, the Commission can block payments until its staff agree that sufficient information has been provided by the Managing Authority and that the domestic Audit Authority has undertaken an effective assessment of systems, as well as an audit strategy.

(iii) Improving coordination between audit authorities

One issue identified in the Commission's action plans is the need to improve coordination between authorities responsible for different aspects of financial control and audit. Some coordination fora have been in place for some time, such as the annual meetings of the 'Homologues' Group' of representatives from Member State control bodies, Commission Structural Funds auditors, OLAF and the European Court of Auditors. However, additional steps have been taken in recent years to enhance cooperation and information-sharing between the Commission and the Court, between Commission DGs, and between EU and Member State authorities.

DG Regional Policy, DG Employment and the Court have reached an agreement on the content of their audit work, notably key requirements on Member States' activities, as well as the methods to be used in assessing those requirements. Moreover, if one of the EU authorities has already undertaken a specific audit, this should not be repeated by another authority, unless there are seen to be weaknesses in the original audit or if new issues have arisen.

Steps have also been taken to improve coordination between Cohesion policy and OLAF's anti-fraud activities. The Structural Funds General Regulation (1083/2006) and Implementing Regulation (1828/2006) in 2007-13 incorporate OLAF's rules relating to audit and financial irregularities. Thus Cohesion policy and OLAF now share a common language and a common approach when dealing with financial irregularities.

Similarly, DG Regional Policy and DG Employment now cooperate more strongly, in the context of efforts to build an integrated internal control framework. They have a shared audit strategy, with common priorities and a common methodology (e.g. in shared checklists for audit visits). The two DGs also exchange information on the results of their audit work in the Member States. Some differences in approach remain, however, partly due to the different types of spending undertaken under the ESF and ERDF, which can mean that different types of error of financial irregularity arise.

The Fund DGs are also endeavouring to improve coordination with the work of Member States' auditors, and are also working to facilitate the exchange of information and experience between EU-level and Member State auditors. For example, DG Employment staff will accompany selected Structural Funds Audit Authorities in their visits to Managing Authorities and projects in 2007-13, rather than duplicating this work. The DG's separate audits will focus on themes which are not being targeted by domestic Audit Authorities.

(iv) Emphasising the responsibilities of the Member States

A further aspect of the response of EU authorities is to emphasise the responsibilities of Member State authorities in relation to financial management, control and audit. The revised Financial Regulation of 2002 (amended in 2005, 2006 and 2007) defines the roles of the Commission and Member States in policy fields implemented via 'shared management'. Among the new initiatives in recent years are increased requirements on Member States to provide both political statements and technical reports on their own approach to the management, control and audit of EU resources. The Commission also places a stronger emphasis on the need for Member States to set up sufficient checks and balances to prevent financial irregularities, as well as for programme-level internal audit processes to stimulate incremental 'learning' among all relevant organisations.

At a political level, EU authorities, led by the Parliament, have called on Member States to issue their own annual Statements of Assurance in relation to their use of EU funds.[30] To date, only Denmark, the Netherlands, Sweden and the UK have responded positively to this request.[31] The Dutch Minister of Finance has issued two annual statements of assurance (in 2007 and 2008), focusing only on Common Agricultural Policy expenditure, although it has said that the 2009 statement will also cover Structural Funds expenditure. Denmark's supreme audit authority has produced a national audit opinion on the country's use of EU funds. Sweden and the UK have announced that they plan to produce Statements of Assurance.

In addition, the 2006 Inter-Institutional Agreement[32] and the 2006 amendment to the Financial Regulation state that each Member State shall produce an annual national summary of audits and declarations in relation to financial management and control, with the first summary being delivered in February 2008. The Annual Activity Reports of the relevant Commission DGs provide a brief analysis of the quality of the annual summaries; the 2007 Reports stated that few annual summaries complied with the minimum requirements of the Financial Regulation.

Further steps have also been taken specifically in the field of Cohesion policy, notably the introduction of the 'Contracts of Confidence' approach, whereby DG Regional Policy and/or DG Employment sign a contract with an individual Member State or regional authority, which acts as a guarantee of the quality of domestic authorities' audit work (see Box 6). Once a contract has been signed, the relevant Commission staff no longer undertake audit visits to the Member State or programme concerned, although they continue to monitor domestic audit reports. To date, DG Regional Policy has signed Contracts of Confidence with Wales, Austria, Denmark, Estonia, Slovenia and Portugal for the 2000-06 period. The contracts will not be extended automatically to the 2007-13 period, although new contracts may be signed once Commission staff have assessed the domestic audit systems, strategies and reports for the new period.

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[30] European Parliament (2008) *No policy without full accountability, Working document No. 1 on the EU budget review,* Brussels, Committee on Budgetary Control.

[31] European Commission (2008) Press release: The Netherlands issues its second annual assurance on spending EU funds, Brussels, 7 July 2008.

[32] European Parliament, European Council and European Commission (2006) *Inter-institutional agreement on budgetary discipline and sound financial management,* Official Journal C139/1, 16 June 2006, Article 44.

Box 6: The rationale behind the/ approach to 'Contracts of Confidence'

A Contract of Confidence is a voluntary agreement between a Commission DG (DG Regional Policy or DG Employment) and an individual Member State or region. It is seen as one means of endeavouring to simplify Cohesion policy management, of enhancing coordination and of ensuring the efficient use of audit resources. The aim is to enable the Commission to rely on audits done by Member States, thereby reducing the need for auditing by the Commission. The initiative is based on a Commission Communication adopted on 18 May 2004 and has received the political backing of the European Parliament and Council.

The qualifying conditions are that the Commission must be satisfied with the effective functioning of the management and control system at Member State or programme level, and also with the audit strategy and the quality of the annual control report. The signature of such a contract usually follows an iterative process of assessment and discussion between the Audit Authority and Commission staff lasting two or three years. The starting point is the agreement of a set of actions to remedy detected weaknesses in the control system. As a result of the successful implementation of these actions and the development of a satisfactory audit strategy covering all audit activity for the whole period of implementation, the Commission concludes that programmes are in general managed in a sound and reliable way.

Moreover, the 2007-13 Structural Funds regulations place more emphasis on the effectiveness of domestic systems of checks and balances, notably via the enhanced role of the domestic Audit Authorities. Similarly, in 2007-13 Member States are responsible for defining the eligibility of expenditure – an issue which accounts for a significant percentage of financial irregularities in Structural Funds audits.

Lastly, the Commission is emphasising that financial control and audit should be seen as a preventative, 'learning' process, implying that the emphasis should not only be on identifying problems but also on proposing solutions. Thus, audit is not simply viewed as a means of uncovering fraud or major mistakes but also about finding ways of doing things better so that minor mistakes can be prevented. In this context, the Commission has provided a 'self assessment tool' to Member States, aimed at encouraging them to assess and improve their own financial management, control and audit systems.

(v) Defining the tolerable risk of error

A final issue which has recently received significant attention relates to the notion of tolerable levels of risk of error. At present, two percent is the maximum level of material errors which can acceptably be found in financial controls for all components of the EU budget. However, in 2004 the European Court of Auditors questioned whether this level was appropriate for all parts of the budget, given that financial control activities are costly, so that an appropriate balance is needed between the costs and benefits of such controls.[33] The European Parliament has followed up the Court's question in its annual budget discharge reports, and also in a workshop held on 12 July 2006.[34]

One issue is whether different risk levels should be set for different policy areas, with a very low level for the financial control of internal administrative costs and a higher level for budget fields seen to be characterised by stronger inherent risk, where it may not be

[33] European Court of Auditors (2004) *op. cit.*

[34] http://www.europarl.europa.eu/comparl/cont/site/auditions/workshop_en.htm

possible to achieve a two per cent level of risk at acceptable costs.[35] Many components of the EU budget, including Cohesion policy, are seen to have an inherently high level of risk due to their long delivery channels and complex rules; the large numbers of actors involved in financial management; the allocation of funding to complex, multi-annual projects; and the reliance on beneficiaries to certify that expenditure has been completed.

The recognition that the complexity of Cohesion policy frameworks and procedures increases the risk of error has, however, raised a further issue, namely the possibility that this risk could be lowered if the sources of risk could be reduced. This might include efforts to ensure that rules are clearer and simpler, as well as to limit the number of organisations and governmental levels involved in implementation.[36]

The Commission is planning to launch a Communication on this theme by the end of 2008.[37] In addition, it is funding two studies, one on the specific costs of financial control and audit, and the other on the total costs of Structural Funds implementation; these studies will provide inputs to the work of defining the optimal intensity of controls for a tolerable risk of error.[38] The initial pilot phase of the study on the costs of financial control found that the cost of controls was on average around 3.5 percent of ERDF payments, but that this figure diverged widely across Member States and regions, ranging from below 0.5 percent to over 12 percent.[39] This divergence may be due, for example, to differences in administrative structures, salaries, and the intensity of checks. The pilot study also found that management verifications (Regulation 438/2001, Article 4) accounted for around 88 percent of total control costs, while certification costs (Article 9) represented around 2.5 percent of the total, and audit costs (Articles 10 and 15) around 9.5 percent of the total.

3.3 A summary of challenges and responses

Although significant work has been undertaken to improve the financial management, control and audit of EU Cohesion policy, a number of challenges remain. These concern the still persistently high level of financial irregularities which are found by auditors; the increasing burden of financial control and audit activities; and difficulties in appropriately allocating tasks between EU and Member State authorities. The main recent responses to these challenges relate to the development of an integrated framework for budgetary control; improvements of the Commission's own systems for financial control and audit; steps to enhance coordination between audit authorities at different levels; a stronger emphasis on the responsibilities of Member State authorities; and efforts to re-define the tolerable risk of error.

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[35] European Court of Auditors (2008) Response to the Commission's communication 'reforming the budget, changing Europe', Luxembourg, 09.04. 2008.

[36] Rafalzik (2008) *op. cit.*

[37] European Commission (2008) Press Release: Siim Kallas presentation of the Commission's synthesis report, *European Parliament's Committee on Budgetary Control*, Brussels, 8 September 2008.

[38] DG Regional Policy (2008) Call for tenders by open procedure n° 2008.CE.16.0.AD.056: Contract Study *"Regional governance in the context of globalisation"*, Brussels.

[39] DG REGIO document provided to EPRC '*Facts and figures on control and audit'*.

4. THE ROLES AND VIEWS OF EU AUTHORITIES

Various EU institutions are responsible for tasks which contribute to the internal control of expenditure and revenue under the Community budget. These mechanisms aim to ensure that all financial operations are legal and justified; that all expenditure and revenue collection procedures are undertaken effectively and efficiently; and that all procedures respect the principles of sound financial management.

4.1 The European Court of Auditors

4.1.1 The roles of the Court

The Treaty (Articles 285-287) gives the European Court of Auditors responsibility for auditing the accounts and implementation of the EU budget, with the aim of improving financial management and also of ensuring accountability and transparency.[40] In particular, the goal of the Court's audits is to ensure that the EU budget's public accounts are transparent and reliable; that operations are undertaken in accordance with existing laws and rules; and that the implementation of the EU budget is as effective and efficient as possible.

The Court itself has no power of sanction in relation to the implementation of the EU budget. However, the Parliament and the Council rely on the Court's reports and opinions in their decision-making and in ensuring effective control over the implementation of the EU budget. In addition, if the Court's auditors believe that fraud may have occurred, they inform OLAF, which investigates the matter further. If one of the audit missions of the Court is seen to require other types of follow-up work (e.g. the provision of additional information), the Court passes this work on to the relevant DG of the European Commission.

The Court draws up an annual report on the EU budget at the end of each financial year, and also produces special reports or opinions on specific subjects, all of which are published in the EU Official Journal. The Court can also undertake on-the-spot investigations in any body which manages revenue or expenditure on behalf of the EU; in the Member States, these audits are undertaken in cooperation with domestic audit authorities.

The main content of the Court's annual report is a Statement of Assurance on the Commission's implementation of the EU budget in the previous financial year (i.e. the 2008 report published in mid November will cover budget implementation in 2007). The Statement of Assurance provides an opinion on both the reliability of the accounts and also on the legality and regularity of underlying transactions. The 'reliability' of the accounts refers to the extent to which they fully and accurately report the annual financial results, as well as assets and liabilities. The 'legality and regularity' of transactions relates to the extent to which income and payment transactions have been calculated accurately and have complied with all relevant rules and regulations.

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[40] European Union (2008) *op. cit.*

4.1.2 *The views of the Court*

Despite the significant emphasis in the past ten years on improving financial control and audit, the European Court of Auditors' reports have continued to criticise the financial implementation of Cohesion policy, and to find high levels of errors in payments to final beneficiaries. The Court has not given a positive Statement of Assurance since it was introduced in 1995 (for the financial year 1994); it has declared that that the EU accounts are reliable, but has found high levels of irregularities in transactions concerning receipts, commitments and payments. The Commission has provided a series of responses to the Court's criticism (see Section 4.3).

(i) Annual report for the financial year 2006

The report for the financial year 2006 (published in November 2007) was based on 177 audits of Cohesion policy projects (77 ERDF projects, 60 ESF projects, 30 EAGGF projects and 10 Cohesion Fund projects), as well as audits of the 17 Operational Programmes which funded these projects.[41] In addition, the Court examined 15 audits undertaken by the Commission.

The Court found that only 31 percent of projects audited were free from error, and estimated that 12 percent of total Cohesion policy resources reimbursed to final beneficiaries should not have been reimbursed. The Court concluded that Member States' control systems were 'generally ineffective or moderately effective' and that the Commission undertook 'only moderately effective supervision to mitigate the risk that the control systems in the Member States fail to prevent reimbursement of overstated or ineligible expenditure' (p.152). Table 1 sets out details of the main types of error found.

Table 1: Percentage of projects found to have different types of error in the sample audited for the European Court of Auditor's annual report for the financial year 2006

Type of error	ERDF	ESF
Irregular public procurement procedures	34	20
Incorrect co-financing rate	26	0
Non-respect of rules	23	14
Missing documents	16	39
Revenue not deducted	1	14
Overheads	0	13

Source: DG REGIO in-house document 'Facts and figures on control and audit'.

The Court's report for the financial year 2006 made the following recommendations on Cohesion policy:

[41] European Court of Auditors (2007) *op. cit.*

- Member States should try to prevent errors by working with project promoters from the application stage, and ensure that they are aware of rules on eligibility and record-keeping;

- Member States should provide sufficient training for staff, not least so that managing authorities have the skills to review project applicants' approaches to costing and contracting;

- the Commission should focus its audit and supervisory activities on the managing authorities, and regularly assess the effectiveness of all managing authorities;

- the Commission should improve procedures for preventing the re-occurrence of any errors which arise; and

- the Commission should encourage the use of regulatory simplifications, such as the use of flat rate amounts for indirect costs in ESF projects, as these should reduce the likelihood of errors.

Each annual report includes a response by the European Commission to the criticisms raised; the Commission's replies to the Court's report for the financial year 2006 are outlined in Section 4.3.

(ii) Annual report for the financial year 2007

The Court's annual report for the financial year 2007 (published on 10 November 2008) did not give a positive DAS. It found that all areas of expenditure were materially affected by errors in payments, except for the headings 'Administrative and other expenditure' and 'Economic and financial affairs'.[42] The report draws on 180 audits of Cohesion policy projects (99 ERDF projects, 56 ESF projects, 21 EAGGF projects and 4 Cohesion Fund projects), as well as audits of the 16 Operational Programmes which funded these projects.[43] The Court also assessed 20 audits undertaken by the Commission.

In relation to Cohesion policy, the report states that 'the supervisory system of the Commission and the control systems of the Member States are generally only partially effective in preventing overstated or ineligible expenditure' (page 12). It states that 46 percent of Cohesion policy projects audited were free from error, and that at least 11 percent of resources reimbursed to the Member States should not have been reimbursed.

The Court's report for the financial year 2007 made the following recommendations on Cohesion policy:

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[42] European Court of Auditors (2008) *Annual report on the implementation of the budget concerning the financial year 2007,* Luxembourg.

[43] European Court of Auditors (2007) *op cit.*

- the Member States and the Commission should reinforce the prevention of errors by working with project promoters and ensuring that first level controls (Regulation 1828/2006 Article 13) function effectively;
- that the Commission should use the simplifications provided for in the regulations and associated rules, without undermining the effectiveness of spending;
- the Commission should make maximum use of the work of Member States' audit authorities, while also monitoring their work; and
- the Commission should make effective use of its corrective instruments to ensure the correct use of EU funds.

The Commission's responses to the Court's criticisms are set out in Section 4.3.

(iii) The Court's contribution to the EU budget review

In its contribution to the EU budget review, the Court has suggested the need 'to think radically about the design of expenditure programmes', for example by considering:[44]

- whether expenditure programmes could be re-formulated in terms of outputs rather than inputs, so that the allocation of funding would be based on the achievement of certain outputs, rather than in the response to proof of spending;
- in the context of the current approach, whether the approach to payment could be simplified, for example via greater use of lump sum or flat rate payments;
- whether greater discretion could be provided when EU funding supports national, regional or local policy initiatives; and
- whether financial control systems could focus on outputs (i.e. the risk objective and the acceptable level of error) rather than inputs (i.e. the number of checks to be undertaken).

4.2 The Council of the European Union and the European Parliament

4.2.1 The roles of the Council and Parliament

The Treaty states that the Parliament and the Council are responsible for determining the financial resources which are needed for the EU budget, as well as the types of expenditure to be undertaken via the budget (Article 314).[45] Further tasks include examining the budget accounts and deciding on the closure of accounts (Article 319).

The European Parliament is responsible for the discharge procedure, which closes the annual accounts of the EU budget. The Parliament undertakes an assessment, based on a

[44] European Court of Auditors (2008) *op. cit.*

[45] European Union (2008) *op. cit.*

recommendation by the Council of the European Union, and also drawing on relevant Court reports, and on the Commission's annual accounts and financial statement. The Parliament may decide to grant, refuse or postpone the discharge of the EU budget. In addition to its formal decision on the budget, the Parliament can address observations to the Commission on specific action to be taken. The Commission must present a follow-up report on discharge to the Parliament, with information on measures taken in response to the Parliament's observations, no later than 15 December of the second year following the financial year that has been closed.

The Parliament's Budgetary Control Committee monitors issues relating to budget implementation by commissioning reports and holding hearings on various themes, including different aspects of Cohesion policy financial management, control and audit. The Committee also examines reports from the European Court of Auditors, and monitors the activities of the Commission in relation to financial control and audit. The other main committees dealing with Cohesion policy resources and implementation are the Regional Development Committee and the Employment and Social Affairs Committee.

4.2.2 The Parliament's views

The Parliament's annual reports on the discharge of the EU budget have repeatedly criticised the approach taken to the financial management, control and audit of the EU budget in general, and of Cohesion policy in particular. Its criticisms draw in part on the EU budget and in part on its own findings, based on hearings with Commissioners and Commission staff, as well as its own studies. Nevertheless, the Parliament has discharged the EU budget in each year except 1984 and 1998.

The Parliament's decision of 22 April 2008 on the discharge the 2006 budget provided some broad conclusions.[46] It welcomed the Commission's agreement that one Commissioner would present a report to the Committee on Budgetary Control each month, in order to provide information on follow-up action agreed with the Parliament. It also called on the Commission to promote national management declarations in the context of its action plan on an integrated internal control framework, arguing that these declarations would enable the Commission to present complete and reliable figures on the recovery of funds spent or managed improperly.

In addition, the Parliament set out an extensive series of comments on specific budget headings, both in general and in detail. For example in addition to some general comments on Cohesion policy (see **Box 7**), the report includes further detailed comments on the financial management, control and audit of Cohesion policy (ERDF, ESF and Cohesion Fund).

[46] European Parliament (2008) *Decision of 22 April 2008 on discharge in respect of the implementation of the European Union general budget for the financial year 2006*, Brussels.

Box 7: The Parliament's general comments in its decision on the 2006 EU budget

The Parliament's decision on the implementation of the 2006 EU budget sets out a series of general comments on Cohesion policy. It states that the Parliament:

1. Will closely monitor the reporting on the COM action plan on supervisory role in preparing for the discharge procedure for the financial year 2007;

2. Welcomes the Commission commitment to recover any undue payments in 2000-06 before the closure of winding-up procedures;

3. Expects the Commission to inform the Parliament of legal actions brought against Member States due to failure to comply with the Financial Regulation, especially in relation to annual summaries, and expects the respective DGs to provide full assessments of the summaries in their annual activity reports;

4. Welcomes the Commission's commitment to correct all errors found in the Court's annual report for 2006;

5. Requests the Commission to provide full information on its capacity to recover unduly paid amounts;

6. Welcomes the Commission's commitment to suspend payments as soon as serious systemic weaknesses are detected;

7. Looks forward to the Commission's quarterly reports on corrections and recoveries (to be audited by the Court), including the establishment of a system allowing recoveries to be linked to the year when funding was allocated;

8. Calls on the Commission to present a scoreboard on the implementation of the action plan on supervisory role;

9. Reminds the Commission of commitments made at the Parliament's Budgetary Control Committee on 25 February 2008:

a) To provide quarterly reports on the implementation of the action plan, especially on suspension and correction procedures;

b) To produce a detailed timetable for implementing, with the Court, a new reporting scheme on recoveries and financial corrections;

c) To present an action plan aimed at preventing extreme errors;

10. Notes the Commission's commitment to report to Parliament at least twice a year on corrective action taken in response to financial irregularities.

4.3 The European Commission

4.3.1 The roles of the Commission

(i) The main Commission Directorates General

The Treaty on the Functioning of the European Union states that the Commission is responsible for the implementation of the EU budget (Article 317). A number of DGs within the Commission are involved in various aspects of the financial management, control and audit of Structural Funds resources in 2007-13:

One of DG Regional Policy's ten Directorates focuses exclusively on Audit, and focuses on the tasks set out in the Cohesion policy regulations, as well as coordinating activities with the Court of Auditors and OLAF. In addition, the country desks are responsible for various tasks relating to financial management, control and audit in their respective Member States.

One of DG Employment's nine Directorates focuses on Audit, Controls and Evaluation, and one of its units has the specific role of undertaking ESF Audits. As in DG Regional Policy, the country desks are also involved in issues relating to financial management, control and audit.

Although DG Budget does not directly manage EU expenditure, it has the task of drawing up the Commission's accounts, as well as the consolidated accounts of the European institutions. In addition, it is responsible for preparing the rules which govern EU finances, and also provides guidance and training to Commission staff, aimed at promoting sound financial management within Commission departments.

The Internal Audit Service (IAS) was set up in July 2001 in the context of the administrative reform of the Commission, and is led by the Commission’s Internal Auditor. In accordance with the Financial Regulation,[47] the IAS undertakes audits in individual departments of the Commission, as well as on specific themes. It then issues independent audit opinions on the quality of management and internal control systems within the Commission, and makes recommendations aimed at ensuring the efficient and effective achievement of the Commission's objectives.

The European Anti-Fraud Office (OLAF) was set up in 1999 and is responsible for undertaking administrative anti-fraud investigations. Although OLAF is part of the Commission, it has special independent status, and is answerable to a supervisory committee of five specialists who are independent of Community Institutions. OLAF can carry out investigations inside all Community institutions into possible fraud relating to the EU budget.

The Commission’s Legal Service provides support to other DGs by providing legal advice, and it also represents the Commission in all court cases. In the field of Cohesion policy, the Legal Service advises the Fund DGs on the interpretation of the regulations, and is also involved in the process of making financial corrections, as well as representing the Commission in any legal proceedings.

Each DG produces Annual Activity Reports, signed off by the Director General, on the DG’s budgetary activities (see also Section 4.3). These are checked by the Internal Audit Service, and signed off by the Commission’s Chief Accounting Officer. They include details of the financial control and audit activities and findings of each DG. These reports are synthesised in a Commission Communication to the Parliament, Council and Court of Auditors.[48]

Towards the end of each year, the Commission publishes an annual report on the implementation of the Structural Funds in the previous year (i.e. the 2008 document reports on 2007).[49] These reports provide an overview of financial control activities, including the number of audits undertaken for each Fund and each programme period; the number of investigative visits made by OLAF to the Member States in relation to the Structural Funds; and the number of instances of financial irregularities reported by the Member States. In addition, following the Annual Report of the European Court of Auditors

[47] European Council (2002) *op. cit.*

[48] European Commission (2008) *Synthesis of the Commission’s management achievements in 2007, Brussels,* 04.06.2008, COM(2008) 338 final.

[49] European Commission (2007) *18th Annual Report on the Implementation of the Structural Funds in 2006. Brussels,* 6.11.2007 COM(2007) 676 final.

in 2005, as well as requests from the European Parliament and European Council for more information on financial corrections, the eighteenth report in 2007 provided more extensive information on financial irregularities, fraud, corrections and recovery orders.

The Commission also presents reports to the European Parliament and to the Parliament's Committee on Budgetary Control, both in relation to the EU budget as a whole and in relation to specific budget lines, including Cohesion policy.

(ii) Main tasks of DG Regional Policy and DG Employment in 2007-13

Each year, the Director General of each DG must sign a declaration of assurance, which is attached to the DG's Annual Activity Report, stating that spending has been undertaken in accordance with the relevant legal framework and has respected the principles of sound financial management. In order to be able to sign this declaration, the Director Generals depend on work undertaken by their audit staff.

The main aim of the Commission's audit work in areas of shared management, such as Cohesion policy, is to ensure that Member States' financial management, control and audit systems function effectively and efficiently. The main focus of DG Regional Policy and DG Employment is therefore on assessing the operation of management and control systems, although – particularly where their risk analysis procedures identify potential problems - they also investigate individual projects and organisations. Together with OLAF and the Commission's Legal Service, these DGs are responsible for dealing with financial corrections in the field of Cohesion policy.

The DGs have a three-year rolling strategy which defines a standardised audit methodology, and is based on an annual risk assessment exercise that identifies the Member States and programmes to be visited in the following year. After the visit, the Commission provides recommendations to the relevant Managing Authority, and the Member State has a right to reply to these recommendations.

Other key tasks for DG Regional Policy and DG Employment in 2008-09 include reviews of Member State compliance assessments for 2007-13 (Regulation 1083/2006, Article 71) and audit strategies (Article 62), as well as the 2008 annual Audit Authority reports. Further tasks concern the review of Member States reports in relation to the 2000-06 programmes, notably Article 10 checks (Regulation 438/2001) and declarations on the winding up of assistance (Article 15). Moreover, the DGs are still dealing with issues relating to the closure of the 1994-99 programmes.

4.3.2 The views of the Commission

The Commission has recognised that systems for managing, controlling and auditing certain aspects of EU budget expenditure, including Cohesion policy spending, has been, and still is, characterised by various weaknesses, which lead to an unacceptably high level of financial irregularities, although it disputes some of the Court's findings and interpretations. The Commission is committed to improving the quality of these systems; the Fund DGs, for example, now see the main need in terms of ensuring that audit rules are applied properly in all Member States. In January 2005, the Barroso Commission set itself the goal of achieving a positive Statement of Assurance from the Court before the end of its mandate in December 2009.

(i) Commission responses to the European Court of Auditors

Each annual report by the Court of Auditors includes a response by the Commission to the specific criticisms made. We here outline the Commission's responses to the reports for the financial years 2006 and 2007.

Report for the financial year 2006

In the report for the financial year 2006 (published in November 2007), the Commission raised a number of issues in relation to the Court's interpretation of their findings, as well as on the approach of the Commission and the Member States to financial control and audit, including the following points:[50]

First, the Commission questions the Court's classification of errors and interpretation of findings. It notes that the Court data show that 56 percent – rather than the 31 percent cited by the Court - of projects were correctly reimbursed, if these included projects where the only errors related to 'compliance' (i.e. contracting or publicity requirements) and had no financial impact.

Second, the Commission argues that some of the weaknesses identified are mainly formal (e.g. relating to poor documentation on controls) and are in any case being addressed both by managing authorities and by the Commission.

Third, the Commission argues that the multi-annual character of the financial control systems managed by the Commission and the Member States reduces risk because it allows corrections to be made after funds have been disbursed. This suggests that the Court's 'snapshot' approach at a specific point in time may over-estimate the level of financial irregularities over the entire programme period, and does not allow for the fact that many of the errors found are likely to be picked up downstream by the Member States' own financial management, control and audit systems.

Fourth, the Commission states that the Fund DGs' audits of Member States' systems show that between 20 and 35 percent of systems are satisfactory, 60 percent need improvements to correct material deficiencies in key controls, and around 10 percent are seriously deficient. (Percentages refer to the volume of EU funds covered.)

Report for the financial year 2007

The report for the financial year 2007 was published in November 2007 and also included Commission responses.[51] In addition to noting steps already being taken to address the

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[50] European Court of Auditors (2007) *op. cit*. pp.159-161.

[51] European Court of Auditors (2008) *op. cit*. pp.140-155.

Court's main recommendations and other comments and especially to, the Commission makes the following main points:

First, the Commission questions the Court's interpretation of some of its findings. It noted that, in the case of seven of the 97 projects where the Court found errors, these errors did not provide a basis for financial corrections or other follow-up. This would reduce the amount of funding which the Court says should not have been reimbursed (11 percent).

Second, the Commission notes that the Court's audit of Member States systems shows considerable improvements compared to its audit of the financial year 2006. It also states that, for three of the programmes audited, the Commission's own audit (published in the relevant DGs' Annual Activity Reports) provides a more positive assessment.

Third, the Commission emphasises that the Court finds that work of the winding-up bodies in 2000-06 is effective in 14 out of the 16 programmes audited.

Fourth, the Commission disputes some of the Court's criticism in relation to its own audit work, arguing that this has been operationally useful. It also states that the lack of desired impact on the prevention of errors in reimbursement is not due to the lack of effectiveness of its own actions, as it has taken steps to mitigate the risk arising from Member States' weak control systems.

(ii) The DGs' Annual Activity Reports

The Annual Activity Reports of DG Regional Policy and DG Employment provide an overview of the DGs' activities, and have shown an increasing focus on the field of financial control and audit in recent years. The number of pages devoted to this theme in DG Regional Policy's reports has risen from 28 in 2004 to 57 in 2007, and a similar evolution is seen in DG Employment's reports. The reports acknowledge that Cohesion policy is characterised by a number of inherent risks, notably the multiplicity of organisations, systems, operations and beneficiaries; the multiplicity of types of project and programme; and the detailed eligibility requirements at Community and Member State levels which may increase complexity and risk of misinterpretation. They also describe activities undertaken to address this risk, as well as an assessment of the steps taken to improve financial control and monitoring.

The content of the reports has broadened in recent years. For example, DG Regional Policy's 2004 report included details of follow-up activity to reservations and observations made in previous annual activity reports and audits, as well as information on DG Regional Policy's internal control system, and an appreciation of how management and control systems address risks. In contrast, the 2007 report also includes a description and assessment of controls in the Member States; a more analytical approach, drawing on indicators and criteria and providing conclusions on the effectiveness of control systems; follow-up activities in relation to a broader range of recommendations; and more quantified information on the audit work undertaken and on the results of this work. Further elements of the 2007 reports include:

- details of the number of fraud investigations being undertaken by OLAF (by Member State); and also the number of outstanding financial irregularities for 1994-99;
- information on the total number of closure audits undertaken by DG Regional Policy for 1994-99 and 2000-06
- information on follow-up activities on reservations set out in the 2006 Annual Activity Report and follow-up on the Court of Auditors' annual report 2006 (by Member State);
- details of financial corrections undertaken (by Member State and programme) and underway;
- an assessment of the annual summaries of Member States and the degree of compliance with the requirements of the Financial Regulation;
- details of action being taken to correct material deficiencies in Member States' management and control systems (by Member State).

The 2007 reports include an assessment of Member State management and control systems, which demonstrate ongoing weaknesses (see Table 2). Out of a total of 379 ERDF programmes, 52 percent (covering 39.3 percent of expenditure in 2007) were seen to have systems that provided 'reasonable assurance' or 'qualified assurance with moderate impact'. Figures for the ESF were slightly better, with 64 percent of programmes (accounting for 48.3 percent of expenditure in 2007), out of a total of 239 programmes, falling into these two categories.

Table 2: Commission assessment of Member State management and control systems

	ERDF		ESF	
	Number of programmes	As a % of all payments in 2007	Number of programmes	As a % of all payments in 2007
Reasonable assurance	147	28.1	43	10.3
Qualified assurance with moderate impact	50	11.2	109	38.0
Qualified assurance with significant impact	139	47.7	40	33.7
No assurance	43	13.0	47	18.0
Total	379	100	239	100

Note: The results draw on audit opinions drafted by the DGs' audit staff, and on management opinions drafted by authorising officers by sub-delegation (generally, DG heads of units for the relevant Member States).
Source: Annual Activity Reports 2007 of DG EMPL (p.60) and DG REGIO (p.65)

The reports also provide information on the main aspects of Member States' financial management, control and audit systems where the Commission noted reservations (see Table 3). For the ERDF, problems were mainly seen in relation to Articles 4, 8, 9 and 10 of Regulation 438/2001. For the ESF, the main weaknesses were seen in relation to the following requirements of Regulation 438/2001: separation of functions (Article 3), project selection (retrospection), Article 4 controls, the audit trail (Article 7), the certification process (Article 9), and results of the five percent controls (Article 10). Some of the Member States and programmes showed deficiencies only with regard to some of these Articles.

Table 3: Reservations concerning Structural Funds management and control systems for the 2000-06 period

ERDF	ESF
Czech Republic (4 programmes), Finland (4 programmes), Germany (4 programmes), Greece (15 programmes), Ireland (4 programmes), Italy (17 programmes), Luxembourg (1 programme), Poland (3 programmes), Slovakia (2 programmes), Spain (14 intermediate bodies affecting 20 programmes), INTERREG (51 programmes)	Belgium, France, Italy, Luxembourg, Portugal, Slovakia, Spain, United Kingdom

Source: Annual Activity Reports 2007 of DG EMPL (p.68) and DG REGIO (p.69)

(iii) The benefits and disadvantages of the current approach

Commission staff in the Fund DGs argue that the stronger emphasis on financial control and audit has led to improvements in systems and procedures at both EU and Member State levels, which reduce the possibility that final beneficiaries may engage in fraud and in irregularities such as claiming for ineligible types of expenditure. They also emphasise that stronger financial control and audit leads to increased transparency and better administrative procedures, and thus to better project quality and a stronger economic impact. More fundamentally, some staff argue that the stronger emphasis on financial control and audit is leading to a change in mentality, so that there is now a stronger focus on ensuring value for money for taxpayers. Lastly, they argue that the Commission's audit work enables Member State authorities to gain access to additional information on projects and final beneficiaries.

However, Fund DG staff also acknowledge that implementation difficulties can arise in relation to financial control and audit, but argue that these are generally due to differences in approach between EU and domestic systems and rules, rather than because EU rules are inherently more complex. They also argue that tensions and overlaps between EU and domestic rules should be less evident in 2007-13, for example because Member States are now responsible for setting eligibility criteria. In addition, they argue that some of the difficulties experienced by Member States are due to the administrative weaknesses of final beneficiaries, which may, for example, lack appropriate systems for collecting and processing the data needed to comply with Structural Funds rules. Commission staff argue that these difficulties could be resolved, first, if the project selection process included one-to-one meetings with final beneficiaries so that Managing Authorities (or Intermediate Bodies) could assess their capacity to meet EU requirements. Second, final beneficiaries could include the additional costs of EU-related administration and accountancy work in their overall project application.

Commission staff do not agree with certain criticisms which have been voiced of the increased focus on financial control and audit.[52] In particular, they do not believe that the stronger focus on audit leads to greater risk aversion in project selection, as they argue that the same audit procedures apply to all kinds of projects. Similarly, they state that rules on financial control and audit have not been reinterpreted within individual programme periods but instead argue that some Member States have misunderstood, misinterpreted or mis-applied some rules set out in the Structural Funds regulations.

4.4 A summary of the views of EU authorities

Although there is broad agreement among EU authorities of the need to continue to improve the management, control and audit of the EU budget, not least Cohesion policy, there is a lack of consensus over the level of ongoing financial irregularities. While the Court of Auditors and the Parliament remain highly critical of the Commission's approach to the control and audit of Cohesion policy, the Commission disputes some of the Court's findings and interpretations of audit data. All EU authorities agree that many aspects of the EU budget, including Cohesion policy, are characterised by a relatively high level of risk of error due, for example, to the multiplicity of organisations, systems, operations and beneficiaries involved in implementation; the multiplicity of types of project and programme; and the detailed eligibility requirements at Community and Member State levels which may increase complexity and risk of misinterpretation.

[52] Cf. Rafalzik (2008) *op. cit.*

5. THE ORGANISATION OF FINANCIAL MANAGEMENT, CONTROL AND AUDIT IN THE MEMBER STATES

This Section moves from the EU level to an examination of the ways in which programme managers are engaging with Structural Funds rules on financial management, control and audit in the 2007-13 period. It describes the different approaches which Member States are taking to the organisation of financial management, control and audit, focusing specifically on the allocation of tasks between actors. It also explores developments relating to capacity building and staffing, as well as electronic data management systems.

5.1 Organisational responsibilities

5.1.1 Different approaches to the allocation of tasks

The separation of functions is interpreted quite differently by Member States, with management, certification and audit functions being administered by the same organisations in some countries but by completely separate bodies in others. In line with Article 59(4) of the General Regulation, *bodies responsible for managing, certifying and auditing Structural Funds activities may belong to the same body* as long as their individual functions are clearly separated. This is the case in Denmark, England, Lombardia, Sachsen-Anhalt, Scotland and Spain where all three bodies are part of the same organisation.

More often, Managing and Certifying Authorities belong to the same institution but the *Audit Authority is located in an independent institution* (Finland, Spain, Sweden, Vlaanderen, Wales). In these cases, the Certifying Authority can be at the same level as the Managing Authority or located at a higher level; in Poland, for example, expenditure for the regional OPs is certified by the Ministry of Regional Development together with the Voivodship Offices. The Audit Authority is situated either in a Ministry department (Italy [national OPs], Poland), an independent finance inspectorate (Portugal, Vlaanderen), or an inter-ministerial control body (France).

In both the Czech Republic and Slovenia, the Certifying Authority and Audit Authority belong to different departments of the Ministry of Finance, and the Managing Authority is located in a separate body (the National Coordination Authority in the Czech Republic, and the Government Office for Local Self-government and Regional Policy in Slovenia).

Finally, the *three authorities can be placed in different bodies* with Certifying Authority tasks entrusted to another Ministry or delegated body. In Austria, a unit of the Federal Chancellery is responsible and in Portugal, the Financial Institute for Regional Development carries out certifying activities. In France (except for Alsace), regional treasurers, which are representatives of the Budget Ministry, act as Certifying Authorities, whereas in Nordrhein-Westfalen this role is fulfilled by a unit in the *Land*'s bank.

A specific situation applies in Greece where the Ministry of Economy and Finance hosts all three authorities for some, but not all of the Operational Programmes (see Box 8).

Box 8: Greece - Allocation of managing, certifying and audit responsibilities

In Greece, management responsibilities for most national OPs are allocated to sectoral ministries while the Ministry of National Economy and Finance pools management tasks for regional OPs, the Digital Convergence OP and Technical Assistance. Within the Ministry, special units are in place, which function as Certifying and Audit Authorities.

OP	**Managing Authority**	**Certifying Authority**	**Audit Authority**
Regional OPs	Ministry of National Economy and Finances, National Coordination Authority*	Ministry of National Economy and Finance, special service (former Single Paying Authority for CSF, Community Initiatives and Cohesion Fund, set up in 2000); headed by General Secretary of Investments and Development	Ministry of National Economy and Finance, Financial Audit Committee (EDEL); supervised by General Secretariat of Fiscal Policy (General Accounting Office)
Digital Convergence			
Technical Support for Implementation			
Competitiveness & Entrepreneurship	Ministry of Development		
Environment – Sustainable Development	Ministry of the Environment, Physical Planning and Public Works		
Accessibility Improvement			
Education & Lifelong Learning	Ministry of National Education and Religious Affairs		
Public Administration Reform	Ministry of the Interior, Public Administration and Decentralisation		
Human Resources Development	Ministry of Employment and Social Protection		

* Directorate General for Development Programming, Regional Policy and Public Investment

Where *tasks are delegated to Intermediate Bodies*, these are mainly involved in data inputting and administrative checking. Related arrangements are set out in secondary legislation or contracts, but changes in financial management requirements mean that these still need to be adjusted in some cases (e.g. Scotland). Depending on the programme set-up, Intermediate Bodies can also be entrusted with more important tasks. For the Italian OP Research & Competitiveness, certifying tasks are shared between the Managing Authority (Ministry of University and Research) and the Intermediate Body (Ministry for Economic Development) for their respective programme parts. Where Ministry departments act as Intermediate Bodies this is seen to lead to internal competency problems in some cases. In Niederösterreich, for instance, the Managing Authority is not in a position to issue instructions to the Intermediate Body.

There are also differences between Member States with respect to the *degree of centralisation of the different tasks*. In many Member States, one Certifying Authority is in charge of all Operational Programmes (Austria, Czech Republic, Denmark, Finland, Portugal, Slovenia, Spain, Sweden). In a number of other cases, each Operational

Programme has its own Certifying Authority (Belgium, France, Germany, Italy). There are also cases where Certifying Authorities are in charge of several OPs (Poland regional OPs, UK). As to the Audit Authority, responsibilities can be carried out at the central level, as in Austria, where a department of the Federal Chancellery covers all OPs, while in Germany Audit Authorities are in place at the level of each programme. In Italy, the same Audit Authority deals with the national OPs while regional OPs appoint their own authorities. In Poland, a unit in the Ministry of Finance is responsible at the national level, but separate units are being established in the regional Revenue Offices reflecting the general decentralisation trend. Also, in some Member States central control authorities coordinate their work with delegated bodies at programme-level (Czech Republic, France, Spain).

5.1.2 The separation of responsibilities

For some programme managers, the allocation of tasks between authorities reflects *efforts to improve the separation of responsibilities between the different bodies* as compared to the 2000-06 period when the organisational set-up in some programmes was seen potentially to lead to conflicts of interest. A clarification of roles has notably affected the position of the Certifying Authorities (i.e. former Paying Authorities). To underline related action, the Danish Certifying Authority was physically moved away from the Managing Authority. In Vlaanderen, based on remarks raised during audits on the 2000-06 programmes, the Certifying Authority was separated from the Managing Authority to be functionally independent; it is not part of the Europe Economy unit any more and is now located in a newly set up entity within the Agency for Economy without any hierarchical link to the Managing Authority. Similarly, the separation of managing and certifying tasks has been made more explicit in Wales. Another example can be found in the Italian Research & Competitiveness OP.

However, in some cases, the separation of responsibilities has proved more difficult to achieve and to prove. In France, for example, the member of staff technically in charge of preparing the project decision is also in charge of Article 13 controls (Regulation 1828/2006) since he/she has overall knowledge of the specific project. Problems with conflicts of interest are avoided as the regional *préfet* (the president of the Regional Council in the case of Alsace) ultimately takes the final decision based on the recommendation of the programming committee. In the case of Lombardia, programme authorities have needed to ensure that responsibilities for project selection and administration are clearly separate from payment tasks, given that these lie within the same units. Capacity problems were met by programme managers in Niederösterreich when separating approval, accounting and control tasks since only a limited number of staff is involved in related procedures.

5.1.3 Changes in the allocation of responsibilities

The extent of change in the allocation of tasks, compared to 2000-06, varies between Member States. Significant changes in responsibilities are seen, for example, in Sweden where Nutek is now in charge of Article 13 checks (Regulation 1828/2006) instead of the County Administrative Boards which previously fulfilled the roles of Managing and Paying Authorities. Similarly in Slovenia, on-the-spot verification will be undertaken by the

Managing Authority in 2007-13, whereas the Intermediate Bodies were responsible for this task in 2004-06. In England, a closer alignment between domestic and Structural Funds interventions has meant that managing tasks and responsibility for Article 13 checks have shifted from the Government Offices to the Regional Development Agencies (RDAs). Key issues relate to the retention of skills and the establishment of links with newly appointed bodies.

5.2 Capacity building and staff developments

All Member States have taken significant steps to ensure sufficient human capacity in an increasingly complex field by distributing guidance, training staff and, sometimes, recruiting additional staff. In addition to disseminating Commission guidance, Member State authorities at national and programme levels have been very active in developing their own guidelines. Capacity building is further enhanced by the organisation of meetings and the provision of targeted training seminars at several levels. In some cases, concerns remain over the adequacy of staff numbers to cope with particular tasks in the field of financial management, control and audit.

5.2.1 Capacity building

(i) Commission guidance

EU authorities are a key source of information and guidance for many programme managers. The Committee for the Coordination of the Funds (COCOF) is often seen as an important forum for gaining information. In addition, many individual Managing Authorities have had ongoing contact with Commission staff (Czech Republic, England, Finland, Sweden). Also, indirect advice was gained from audits undertaken by the Commission in 2000-06 and during the negotiation of the 2007-13 OPs (Vlaanderen). The themes addressed concerned systemic issues, such as the separation of functions (Finland, Střední Čechy, Vlaanderen) and the general institutional set-up (Denmark), and operational issues, e.g. eligibility of expenditure and calculation of overheads (Denmark, Finland), implementation of Article 13 samples (Sachsen-Anhalt), irregularities (Střední Čechy), and venture capital (England). Many Managing Authorities also asked for advice on issues relating to public procurement, State aid and revenue-generating projects.

Overall, programme managers felt that the guidance provided by the Commission helped them in dealing with potential concerns, although some guidance was not seen as sufficiently targeted; there were sometimes inconsistencies in the approach taken by different Commission DGs; and guidance sometimes arrived too late in the process.

(ii) National guidance and training

At the level of the Member States, national authorities often interpreted and communicated EU-level advice to the Managing Authorities (Italy, Poland, Portugal). Guidance was also provided by coordinating bodies (Greece) or by the Certifying or Audit Authorities (Austria, Portugal). Additionally, meetings were organised in some of the Member States, such as in Germany (sometimes in cooperation with the Commission) and Italy. Documentary support was made available in some cases. In England and Spain, user manuals with targeted guidance were disseminated and in Italy, the Inspectorate General for Financial Relations with the EU (IGRUE, located in the Ministry of Economy and Finance) developed guidelines for the Managing Authorities. Guidance and training was sometimes also targeted at Audit Authorities. In Austria, for example, more targeted guidance was provided to Audit Authority staff in a handbook. In the Czech Republic, training sessions were organised by domestic auditors for Audit Authorities and Managing Authorities. More generally, a number of guidelines were published by Czech authorities on the theme of financial management, control and audit which were seen as helpful by the Managing Authorities (see **Box 9**).

Box 9: Czech Republic - Guidelines by the Certifying Authority and the National Coordination Authority

The following documents were published on financial management, control and audit by the Ministry of Finance and the Ministry for Regional Development (MRD):

- Guideline for financial flows and control of the programmes co-financed by the Structural Funds (SF), Cohesion Fund (CF) and European Fisheries Fund (EFF) for the programme period 2007 – 2013 (Ministry of Finance);
- Guideline for expenditure certification for the programme period 2007 – 2013 (Ministry of Finance);
- Instructions conditioning the guideline of the reporting of irregularities detected in the course of implementation of the SF, CF and EFF and in the frame of financing of the CAP to the OLAF (Ministry of Finance);
- Guideline – Irregularities, actualisation for 2007 – 2013 period (MRD);
- Guideline for the public procurement under the Public Procurement Law (N°137/2006) and guideline for the public procurement financed from the EU resources (MRD).

(iii) Guidance and training by Managing Authorities

Managing Authorities were also active in providing guidance and support. In this context, documentary guidance was provided by the Managing Authorities to Intermediate Bodies, e.g. in Śląskie (a user manual) and in Slovenia (guidelines on Article 13 controls). In Niederösterreich and Nordrhein-Westfalen, targeted guidance was also made available. Furthermore, training seminars and meetings were organised on general themes by Managing Authorities for their internal Structural Funds units, Intermediate Bodies and other project workers (Czech Republic, Finland, France, Sachsen-Anhalt, Scotland, Steiermark, Śląskie, Spain, Sweden). In Greece, this was facilitated by the Ministry of Economy and Finance, assisted by the Management Organisation Unit. In Scotland, additional courses are being organised by an external consultant and are compulsory for staff in the Managing Authority and Intermediate Bodies.

More specific training has been offered by Managing Authorities on a number of issues: financial control and audit (Austria, Finland, Slovenia, Střední Čechy), electronic data systems (Austria, Denmark, England, Finland, Portugal, Slovenia, Wales), administrative verification (Poland, Sweden), on-the-spot checks (Finland, Śląskie [ESF]), Article 16 controls (France, Portugal), eligibility rules (Denmark, Sweden), State aid rules (Denmark, Slovenia), audit trail (Sweden), working methods and procedures (Slovenia, Śląskie, Sweden), public procurement (Slovenia, Śląskie, Střední Čechy, Vlaanderen), construction law (Střední Čechy). In Wales, the Managing Authority has taken a more systematic approach to strengthen financial management and control skills as in 2000-06, some of the beneficiary organisations were seen to be weak at managing Structural Funds projects (see **Box 10**).

Box 10: Wales - Provision of structured training on financial management, control and audit

The Welsh programme Managing Authority (WEFO, Welsh European Funding Office) is putting together a training package which covers the post-approval process, procurement procedures, financial systems, record keeping and retention of documents. This is hoped to increase awareness of audit requirements, improve project management and ensure systems leave a full audit trail, thus minimising the risk of clawback of funds. The training, to be rolled out in the autumn of 2008, will be compulsory for all project managers and staff involved in project management. Staff completing the package successfully will be awarded a 'European Funding Licence'. The initial focus of the training will be on government departments involved in project delivery; it will then be extended to other large organisations. Refresher training will potentially be provided if any areas need to be strengthened. The problem of lack of staff continuity will be addressed by ensuring that if a project manager changes, training will be compulsory for the new project manager. Within WEFO a new team was set up to oversee the guidance on offer, which will also provide a central resource for queries from sponsors.

In some Member States, learning is also being enhanced by an on-going exchange of experience. In Sweden, Nutek's programme support office organises quarterly meetings with regional offices based on questions received. Similar activities are facilitated in Austria by the Austrian Conference on Spatial Planning (ÖROK). In Germany, the *Länder* have exchanged information, e.g. on comments received from the Commission, facilitated by the federal level. In Italy, the General Accounting Office (IGRUE) organised meetings to provide Managing Authorities with guidance and to facilitate exchange of experience. Intense cooperation has also taken place among the regional OPs in the Czech Republic.

5.2.2 Staff developments

There have been different approaches to staff recruitment across Member States, depending on existing human resources and the allocation of tasks between organisations.

While staff numbers in financial management, audit and control will remain overall stable in a number of programmes (France, Greece, Italy [OP R&C], Niederösterreich, Steiermark), additional staff is being recruited in Denmark, England, Sachsen-Anhalt, Śląskie and Vlaanderen.

More specifically, different developments can be identified across programmes in relation to the individual bodies and tasks involved in financial management, control and audit.

- For the *description of management and control systems*, staff shortages were identified in some cases. In Finland, this was due to an internal reorganisation which meant that fewer staff were involved than for the 2000-06 description. In Niederösterreich and Steiermark, additional staff would have been useful but the required training was considered too time-consuming. In contrast, additional skilled staff were recruited during this process in England as part of an overall increase in the capacities of the Managing Authority. In other cases there was no need for additional staff (Sachsen-Anhalt).

- Staffing of *Certifying Authorities* has increased in Finland and Vlaanderen, while it has remained stable in the cases of Austria, France, Sachsen-Anhalt and Wales. In some cases, staff levels are low (only one to two persons), even though this is contrary to Commission guidance (Denmark, Sweden). In Austria, staff numbers are unchanged despite a reduction in EU funding because the workload is expected to be similar as in 2000-06.

- A number of *Audit Authorities* have seen staff levels increase, partly due to increased workloads for dual programme management and tighter work plans (Austria, Denmark, France, Lombardia, Slovenia, Vlaanderen, Wales). In Scotland and Sweden, recruitment efforts are ongoing whereas in England, the body is still under-resourced despite additional recruitment. There are also issues with the lack of experience of newly recruited staff (Vlaanderen).

In some programmes, staff shortages and turnover remain challenging. In the Czech Republic and Slovenia this is notably due to wage competition with the private sector which is a particular issue in a field requiring expertise and experience; however, the situation has improved compared to the 2000-06 period. In Vlaanderen there are concerns that existing staff in charge of administrative checks are not always in a position to deal with the complexity of some requirements (e.g. relating to revenue-generating projects or public procurement). Similarly, the parallel management of two generations of programmes, puts a burden on resources in some cases and impacts on the timing of financial management activities (Scotland).

Furthermore, changes in the allocation of responsibilities between organisations can lead to a loss of skills and experience, although efforts have been made by programme managers to alleviate related effects. In Sweden, for example, it proved sometimes difficult to retain staff from the former Managing and Paying Authorities in the new body at the central level (Nutek); former staff were, however, consulted on the systems description.

In other programmes, the involvement of new actors as Intermediate Bodies has led to the need to develop skills in these bodies. The Italian Research & Competitiveness OP involves Intermediate Bodies and Ministry departments that were not previously involved in Structural Funds administration; this change has led to intense bilateral exchanges between these entities and existing staff involved in Structural Funds implementation in order to establish appropriate management and control procedures.

5.2.3 Outsourcing of tasks

Some programmes have dealt with the organisational requirements by outsourcing tasks, for example to assist in developing electronic data systems (see Section 5.1.3) or in drafting parts of the systems descriptions (Greece, Spain, Steiermark). In Nordrhein-Westfalen the drafting was carried out jointly with the Office for Quality Management in the *Land*'s Bank. In Italy (OPs R&D and Lombardia) the descriptions were entirely drafted externally by the organisations responsible for programme Technical Assistance. Regarding Article 13 checks (Regulation 1828/2006), it was decided in North East England to use Technical Assistance resources to outsource the verification contract because it was considered that Article 4 work had not been properly resourced during 2000-06.

With respect to certifying tasks, Austria has outsourced around 90 percent of related functions to the ERP Fund based on a contract. External support is also provided in Sachsen-Anhalt where certain plausibility checks are undertaken by staff in the *Land* Investment Bank (working on contract to the Managing Authority). Equally, the Audit Authority has outsourced selected tasks to a private auditor, e.g. the drafting of the audit strategy and sample methodology for Article 16 controls (see **Box 11**). Similarly, some outsourced parts of their compliance assessment, such as the Czech Republic concerning the conformity audit. The Spanish Audit Authority also contracted an external firm to assess the systems, but the final assessment was undertaken in-house. In Slovenia, the whole process was outsourced.

Box 11: Use of private sector auditors in Sachsen-Anhalt

The Audit Authority in Sachsen-Anhalt has drawn on the services of a private sector audit firm in drafting the audit strategy for the Land's ERDF and ESF programmes, and in contributing to the development of sampling methodologies. The firm also supported the Audit Authority in its compliance assessment of the programmes' management and control system.

The *Land* also used a private audit firm to undertake internal audit work of the systems underpinning the Structural Funds programmes in 2000-06. This work included assessments of the financial management and control systems of the Managing Authority, Paying Authority and Intermediate Bodies, as well as the provision of annual audit reports to the Managing Authority. This private audit firm will also undertake the declaration on the winding-up of assistance for the 2000-06 period.

One advantage of using a private sector audit firm to provide support is that a larger team can be mobilised to undertake specific work as and when needed. In the past year, for example, Sachsen-Anhalt has needed to undertake audit tasks in relation to the closure of 1994-99 and the 2000-06 programmes, as well as the compliance assessment, the audit strategy and 2008 annual audit report for the 2007-13 programmes.

The option to outsource certain tasks if needed is used by some programme managers in order to achieve greater flexibility in staff management (e.g. on-the-spot checks in Portugal). In the Finnish Regional Council of Keski-Suomi an audit company can be used for on-the-spot checks. The Spanish authorities may involve more external support in auditing activities given the complexities involved in recruiting additional civil servants. Also in Scotland, external audit expertise was brought in on temporary contracts, as well as programme management expertise to help with the closure of the 2000-06 programmes. In Slovenia, despite plans to phase-out the use of external support, extra resources will still be necessary to cope with the scope and complexity of work.

5.3 Electronic data systems for financial management

An important element of financial management, control and audit are data systems which allow actors to access the relevant documentation. Existing systems have been upgraded for the 2007-13 period and, in some cases, new systems have been introduced. This action has been stimulated by the need to comply with EU rules on computerised data exchange, by revised requirements in EU regulations, and also by needs identified at the level of the Member States or programmes.

5.3.1 Changes from 2000-06

Significant changes have been introduced to the design or operation of electronic data systems in several Member States. In Wales and Austria, data systems are now operated online. In Finland, a new system was launched, bringing together previously distinct systems; a single level of data entry is seen as likely to reduce the error rate, and unified templates are expected to ensure data accuracy. Similarly, in England it is hoped to avoid duplication in data inputting and thus reduce the risk of non-compliance with the regulations. A new system was also established in Portugal where the previous approach had proved to be too centralised and revealed communication and implementation problems. In other cases, such as Italy, systems are being upgraded to suit the new programmes and to ensure compatibility with the central database. Where systems are still in the process of being set up or upgraded, delays have led to difficulties with the processing of incoming project data (Scotland).

Efforts have also been made to improve support for financial monitoring, control and audit functions. In Spain, the financial control function is more firmly embedded in the new system. In Greece, improvements have been made with respect to the audit trail. The French database includes a specific module for Article 16 control (Regulation 1828/ 2006) and monitors payment claw-back with an audit trail based on a single file containing all relevant project information. The Welsh system is being upgraded to allow all information coming from project visits to be entered into the system. In Vlaanderen, the data system has been adapted to enhance support in a number of ways (see **Box 12**).

Box 12: Vlaanderen – the electronic data system as support for financial management, control and audit

For the 2007-13 period, the Flemish data system was upgraded to track the declaration of costs by promoters which before were only provided on paper. It works with electronic identity cards and is individually accessible by all involved actors. The compilation of all costs in one file simplifies the audit trail and allows providing detailed, invoiced information to the Commission. The database also records detailed information on the status of individual expenditure categories (e.g. number of accepted/rejected invoices) and project promoters can see directly from the system which costs were not accepted (previously, a general notification was sent to the project promoter with less detailed information). Furthermore, the system contains the control history of each cost (e.g. on-the-spot checks which may change the overall funding allocation of a project) and information on performed audits. Invoices still need to be submitted in paper.

5.3.2 Degree of integration of electronic systems

Systems vary as to the degree to which they cover project implementation stages and whether or not they cover all programmes and funds. They are also connected in different ways with other databases and domestic monitoring systems.

(i) Coverage of different project implementation stages

Many of the new or upgraded electronic systems apply an *integrated lifecycle approach* to data processing, covering all stages of the project lifecycle from application submission to archiving, including audit and control procedures (Austria, Finland, France, Lombardia, Nordrhein-Westfalen, Sachsen-Anhalt, Scotland, Slovenia, Spain, Sweden, Wales). In some

Member States, systems are not yet fully developed, such as in Denmark where the reporting function still needs to be set up, and in England where the system currently only captures data on project application and approval. Also in Śląskie, efforts are ongoing to develop the ERDF database into a programme management tool, and upgrading is still underway in Greece.

In contrast, a number of programmes operate *separate systems for different aspects of project implementation*, notably for financial management, control and audit functions. In the Czech Republic, there are a number of data systems which are specific to certain OPs and project stages. Support is provided by an integrated information system used by the majority of Managing Authorities, the Certifying Authority and the Audit Authority. Additionally, separate systems are in place for financial management and accounting, while the information system of the Audit Authority is still being tested. Some of the regional Managing Authorities, such as in Střední Čechy, also use their own accounting systems.

In many programmes, the Certifying Authority and/or Audit Authority operate a separate electronic data monitoring system for their accounting or audit activities. This is the case in Portugal, where the Certifying Authority has a separate system which covers expenditure certification, financial monitoring and the reimbursement of payment claims to final beneficiaries. Similarly in Slovenia, the Certifying Authority runs an additional electronic data system, and in Italy (OP R&C), the national Audit Authority runs its own separate IT system. Additionally, separate databases may be in place in some cases for specific applications, such as system audits (France).

(ii) Coverage of programmes and funds

In some Member States, systems operate across programmes (Finland, France, Sweden) in an effort to enhance uniformity of data entry and usability. In other cases, programme-specific systems operate (Belgium, Germany, UK). In other programmes (e.g. England), the regional authorities are required to adopt a core set of functions provided by a central database (e.g. programme details, web forms, authentication, online data validation, automated payment). In Italy and Poland, national databases are also complemented by programme-specific systems.

Many programmes use the same electronic systems for several Funds. A single system covers the ERDF and ESF in the Czech Republic, Finland, France, Greece, Lombardia, Sachsen-Anhalt, Scotland and Slovenia. In Wales, the system covers the ERDF, ESF and EAFRD. However, Fund-specific systems are in place in Austria, England, Spain, Sweden and Vlaanderen. Different approaches are also in place *within* some of the Member States. In Portugal, systems operated by the Managing and Certifying Authorities are Fund-specific while the Audit Authority database covers all the Funds. In Poland, the national database applies across all Funds while programme-level systems can have a differentiated approach, such as in Śląskie.

5.3.3 Set-up and updating of systems and data input

The management and updating of systems is mainly managed internally, often with the support of Technical Assistance (Denmark, Finland, France, Lombardia, Nordrhein-

Westfalen, Sachsen-Anhalt, Slovenia, Śląskie, Sweden, Vlaanderen). However, some programmes use external expertise for these tasks. In Spain, Managing Authorities are supported by the State's General Controller and Accounting Directorate, while in Austria these tasks are carried out by an Intermediate Body in charge of programme monitoring (ERP-Fund). The new Welsh system is being run by the Managing Authority's IT section with parallel support by an outside contractor. External support is also used in Scotland.

There are varying approaches to data input depending on the set-up of the electronic system and internal arrangements for data communication. In a limited number of cases, project data can be entered directly by the applicants (Lombardia, North East England, Vlaanderen). Intermediate Bodies are more frequently in charge of data input (Austria, Finland, Nordrhein-Westfalen, Sachsen-Anhalt and Spain). There are also examples where the Managing Authority is the main responsible actor (Slovenia, Sweden), notably where there are no Intermediate Bodies (Střední Čechy). In most cases, there is a mix of actors involved in data entry at different stages of the project cycle. Intermediate Bodies are involved alongside the Managing Authorities in France, Greece, Italy (OP R&C) and Śląskie. In Denmark, Portugal and Scotland, tasks are shared between applicants, Intermediate Bodies and the Managing Authority.

5.4 Summary of Member State approaches

Member States and programmes are taking a range of approaches to the allocation of responsibilities, capacity building and staffing, and electronic data systems. While some decisions taken on the allocation of tasks are rooted in EU rules (e.g. on the formal separation of certain responsibilities), others are driven by domestic factors, notably changes the roles of different domestic organisations. All programmes have taken steps to build capacity in the field of financial management, control and audit in 2007-13, either by training and disseminating advice, or by recruiting additional skilled staff. Adjustments have also been made to electronic data systems, which are key to financial management and control procedures. Some changes have been introduced in response to amendments to EU regulations, while others have been stimulated by domestic problems with earlier systems, or by the desire to improve the efficiency of data management.

6. THE TASKS OF MEMBER STATE AUTHORITIES

Member States and programmes have taken different approaches to the mandatory tasks of the Managing Authorities, Certifying Authorities and Audit Authorities. The following sub-sections examine how the core tasks of these authorities are organised in the Member States and regions. In the case of the Managing Authority, the main tasks analysed relate to the description of the management and control system, as well as administrative and on-the-spot checks. For the Certifying Authority, the focus is on the work involved in certifying statements of expenditure, while for the Audit Authority, the emphasis is on the compliance assessment, the Audit Strategy and the annual control report and opinion.

6.1 The tasks of the Managing Authority

The regulations provide a clear description of the tasks of the Managing Authority in 2007-13 (e.g. Regulation 1083/2006 Article 60). The focus here is on two key sets of tasks in the field of financial management, control and audit, namely the description of the management and control system, as well as administrative and on-the-spot checks. Although Member States' approaches to these tasks are framed and constrained by the Structural Funds regulations, there is still considerable variety across programmes.

6.1.1 Description of the management and control system

Article 71 of the General Regulation (1083/2006) states that Member States must submit a description of all management and control systems before it can submit the first interim application for payment or at the latest within twelve months of the approval of each OP. The description must cover the organisation and procedures of the Managing Authority, the Certifying Authority, the Audit Authority and the Intermediate Body.

(i) Organisation

Member States have taken different approaches to the work of writing descriptions of management and control systems, both in terms of its organisation, notably the degree of centralisation, and also in terms of the actors involved in the drafting process itself. The experiences of programme managers of writing the descriptions also vary, conditioned in part by the extent to which such descriptions were already in place in the programme complement in 2000-06.

Regarding the degree of centralisation, in many Member States, *separate descriptions* were drafted at the level of each OP (Austria, Germany, Poland, Slovenia). In some cases, this happened in a coordinated way, as in the Czech Republic where the Managing Authorities collaborated with the National Coordination Authority, or in France where the Managing Authorities based their descriptions on the same model. In Italy, the General Accounting Office (IGRUE) played a coordinating and quality checking role, reviewing all descriptions before their submission to the Commission. In a number of other cases, *joint descriptions* were drafted either covering several or all OPs. In Sweden, this process was largely based on contributions from Managing and Certifying Authorities, as well as from the County Administrative Bodies, which were responsible for these tasks in 2000-06. In Finland, each

OP submitted its individual description which fed into a joint document. In England, Scotland and Wales, the descriptions were drafted by the Managing Authorities to cover all the OPs.

The *drafting process could be carried out internally or externally*. Most descriptions were drafted internally by bodies involved in programme management and implementation. Managing Authorities were mainly in charge of related tasks (Austria, Denmark, France, Slovenia, Střední Čechy, Vlaanderen). The new Swedish Managing Authority consulted previous Managing and Paying Authorities in the process. In Greece, Spain and Steiermark, additional support was provided by an external consultant while in Nordrhein-Westfalen the drafting was carried out jointly with the Office for Quality Management in the *Land's* Bank. In other Member States, a mixed approach was applied, involving Intermediate Bodies, Managing, Certifying and Audit Authorities (England, Finland, Poland, Portugal, Sachsen-Anhalt, Scotland, Wales). Only in Italy were the *descriptions wholly drafted externally* by the organisations responsible for programmes' Technical Assistance, based on input provided by the Managing Authority and Intermediate Bodies.

(ii) Experiences of programme managers

While some programme managers saw the description process as relatively straightforward since it followed the same approach as in 2000-06 (Sachsen-Anhalt, Sweden), others felt that the process was very different due to the fact that payments are conditional on the Commission's approval of the systems in 2007-13 (France). Many experienced difficulties related to *time pressures and coordination with other tasks* (Denmark, Portugal), not least because the exercise was more detailed and resource intensive than expected (England, Greece, Niederösterreich, Scotland, Spain, Vlaanderen, Wales). In some cases, the description had to be revised several times (Steiermark), with feedback loops with different bodies (Śląskie regional OP). In Denmark, there was felt to be a trade-off between the level of detail required and the flexibility to adapt procedures at a later stage.

Furthermore, there have been *difficulties with describing complex domestic contexts* and their interaction with Structural Funds rules, notably where a number of Intermediate Bodies are involved in programme implementation. For the Italian Research & Competitiveness OP, the challenge was to provide a formal basis for a complex programme that involves a larger number of instruments, as well as actors with limited know-how on Structural Funds management and control procedures. In Niederösterreich, the difficulty was not so much to ensure coordination itself but to document existing procedures in more detail. Similarly in Nordrhein-Westfalen, many of the Intermediate Bodies did not have full written descriptions of related tasks and are often oriented primarily towards domestic schemes rather than Structural Funds procedures. In Lombardia, concerns mainly related to the audit trail and the level of detail required during controls; in general, the structure of the description was considered too complex.

Nevertheless, the *exercise was also seen as useful* by some programme managers. In England, the description is considered to be a valuable resource that provides a concrete and clear framework that gives the Managing Authority a stronger foundation to deal with any queries or issues arising. Also in Greece, the description procedure, although demanding, proved to be useful for the National Coordinating Authority since it allowed various issues and task allocations to be settled from the start. Coordination is felt to have improved in other cases, such as in Niederösterreich, notably between the Managing Authorities and the Audit Authority. Looking to the future, there are concerns as to how the continuous updating of the systems descriptions will be carried out in practice, e.g. relating to the nature of change and the timing of related notifications (Niederösterreich).

6.1.2 Checks carried out by the Managing Authority

In accordance with Article 60b of the General Regulation (1083/2006) and Article 13 of the Implementing Regulation (1828/2006), the Managing Authority in 2007-13 is in charge of two kinds of checks aimed at ensuring that the expenditure declared is real, that the products or services have been delivered in accordance with the approval decision, that the applications for reimbursement by the beneficiary are correct, and that the operations and expenditure comply with Community and national rules.[53]

(i) Administrative verification of project information

Depending on the institutional set-up, the administrative verification of project information involves Intermediate Bodies and Managing Authorities to different degrees.

- For many programmes, these *checks are undertaken by Intermediate Bodies* with the Managing Authorities verifying the robustness of the information (Austria, Denmark, England, Finland, Nordrhein-Westfalen, Sachsen-Anhalt, Scotland). Procedures applied in the process are based on specific agreements between the Managing Authority and Intermediate Bodies (e.g. Italy Research & Competitiveness OP). In Spain, the control unit of the Managing Authority frequently checks Intermediate Bodies, with the more important bodies being checked annually and others being checked every two years.

- In other cases, specific actors or units within the *Managing Authorities are in charge of related checks* (e.g. Greece). This can mean that information is checked by those actors in charge of a specific Priority or Measure (France, Lombardia) or by a financial unit within the Managing Authority (Vlaanderen, Wales). In Střední Čechy, the Department of Project Administration and the Department of Project Implementation and Payments are responsible, while in Sweden verification officers in Nutek's regional programme offices undertake these tasks.

- In some programmes, these checks are undertaken by actors responsible for each specific Measure, with some actors being located in the Managing Authority and some in a range of Intermediate Bodies and administrative entities (Italy OP R&C). Thus checks are *partly undertaken by staff in the Managing Authority and partly by staff in other entities*. A mix of approaches is also taken in Portugal, where checks are either undertaken by Managing Authorities or by Intermediate Bodies under the

[53] For the 2000-06 period, these checks were set out in Article 4 of the 438/2001 Regulation on the management and control systems. They are more commonly referred to as 'first level controls'.

supervision of the respective programme Managing Authority. In the case of Slovenia, the Managing Authority is in charge of the checks but the Intermediate Bodies are also involved in the process.

Usually, verification of the eligibility and accuracy of expenditure is based on payment applications, transaction lists and progress reports provided by beneficiaries. This can entail further communication with beneficiaries if explanations or missing documents are required and is followed by the approval or rejection of the application. It can happen at the moment of the submission of individual claims (France) or based on project reports and transaction lists of all invoices (Scotland). In some cases, plans or checklists are used to guide verification work (Spain, Sweden).

As regards the *scope of administrative checks*, most programme managers verify information for 100 percent of projects (Austria, England, Finland, France, Italian programmes, Nordrhein-Westfalen, Portugal, Sachsen-Anhalt, Slovenia, Spain, Střední Čechy, Śląskie, Vlaanderen). This does not always correspond to 100 percent of expenditure. In Sweden, for example, random controls based on risk assessment are carried out at the project level. In Scotland, 20 percent of the value of each claim is checked back to source documentation. In Greece, an alternative approach, based on an advanced sampling method, is taken in the case of large amounts of funding allocated by the same body. Others apply checks to a minimum percentage of projects, such as in Wales where around 10 percent of the cost of each funding category is verified, with a minimum of two invoices being checked.

In line with Commission guidance, some programmes require *auditors' certificates* in order to facilitate the work carried out by the Managing Authorities.[54] In Wales, for instance, annual audit certificates need to be provided as part of project progress reports. In North East England, external audit certificates have to be submitted before the final claim can be paid if the project receives over £20,000 (c. €24,000) of public funding in the case of private sector projects, or over £50,000 (c. €61,000) of public funding in the case of public sector projects; if a project receives £250,000 (c. €300,000) or more, it may be required to produce an audit certificate on an annual basis. In addition, some the claims are double-checked in North East England (a separate team in the Intermediate Body reviews a random sample of up to 20 percent of claims).

Overall, programme managers are focusing on issues related to financial management, control and audit very early in the implementation process. Already during project appraisal and selection, increased attention is being paid to the capacity of applicants to fulfil relevant requirements. Also, in order to ensure that beneficiaries are in a position to implement projects effectively, specific steps are sometimes taken up-front as part of the verification process (see **Box 13**).

[54] DG REGIO (2008) *Guidance document on management verifications to be carried out by Member States on operations co-financed by the Structural Funds and the Cohesion Fund for the 2007-2013 programme period*, 29.05.2008.

Box 13: Focus on beneficiaries' capacities

A number of programme managers have increased their focus on the capacities of final beneficiaries to implement projects, especially larger projects. This can be done in several ways:

- *Checks on applicants' track record*: In **Denmark**, the financial position and administrative capabilities of applicants are certified by an accountancy firm appointed by the Managing Authority. In **Střední Čechy**, a number of data systems are checked to gain more insight into the applicant (e.g. real estate register, policy records, declaration of taxes, register of economic subjects). In **Lombardia**, the databases of the Chambers of Commerce are used for similar purposes. In **North East England**, this is done as part of the 'engagement visit' to ensure that applicants are able to implement their projects and to fulfil all future monitoring requirements (particularly record keeping).

- *Risk analysis*: In **Střední Čechy**, risk analysis is carried out as part of project appraisal and is based on a scoring methodology. The analysis covers around 70 percent of project applications which have gained the minimum threshold of points, and which would cover around 120 percent of the funding offered under the relevant call.

(ii) On-the-spot checks in projects

In a number of cases, on-the-spot checks are carried out by the bodies which are in charge of administrative verifications, i.e. by Intermediate Bodies (Austria, England, Finland, Nordrhein-Westfalen, Sachsen-Anhalt, Spain) or Managing Authorities (France, Greece, Sweden). Some Managing Authorities have separate units to undertake the different checks. In Wales, administrative verification is undertaken by the payments team while on-the-spot checks are carried out by the projects inspection and verification team. In Střední Čechy, the Department of Project Administration does ex ante desk checks and the Department of Project Implementation and Payments is in charge of interim and ex post desk checks and on-the-spot checks at all stages (ex ante, interim and ex post).

In other cases, Managing Authorities are responsible for on-the-spot checks, while administrative verifications are carried out by the Intermediate Bodies (Denmark, Portugal, Slovenia, Steiermark). In a limited number of cases, on-the-spot checks are carried out by domestic controllers, such as in Vlaanderen, where some of the staff of the Economics Inspection unit within the Agency for Economy are responsible for these tasks. Some are considering the option of using external support, such as the Regional Council of Keski-Suomi where an audit company can be used when needed; also in North East England, the Intermediate Body is supported by a consultant to carry out additional visits for more risky projects.

Approaches to on-the-spot checks can be more or less systematic as can be seen from the following examples:

- *Plans and checklists* are sometimes used, for example in Sweden where a plan is developed by the Managing Authority for each programme area listing the relevant projects and the timing of the checks. In France, Managing Authorities have to carry out checks in the framework of an annual control programme.

- Others apply a *staged approach*, e.g. Střední Čechy. Here, checks are undertaken at different stages of the project lifecycle, i.e. ex ante, interim and ex post. In England, engagement visits are carried out in order to assess risk and to ensure that applicants are able to implement their projects and to fulfil all future monitoring requirements. This is followed by progress and verification visits to assess progress on delivery and spending. Standard checks can also be complemented by random checks on transactions across claims (e.g. Wales).

In Finland, a very structured approach is applied to on-the-spot checks based on the involvement of Intermediate Bodies (see **Box 14**).

Box 14 Finland: On-the-spot checks and annual 'Audit Strategies' by Intermediate Bodies
All Intermediate Bodies are required to carry out on-the-spot checks on the basis of an annual Audit Strategy. These strategies contain information on: all projects subject to on-the-spot checks; the rationale behind the on-the-spot checks; the number of checks per programme; the description of the selection method; as well as other issues related to data verification. The annual Audit Strategy must be saved in the electronic system (EURA2007) by the end of February of each year. Alongside the annual Audit Strategy, the Intermediate Body is required to prepare a summary of the on-the-spot checks (including results) carried out in the previous year.
On-the-spot checks are undertaken at least once during the lifetime of projects that receive public funding of over €500,000, as well as other projects that are considered to be of high risk. Of the remaining projects, at least 50 percent are checked, taking into consideration a balanced representation of different beneficiaries, projects and risk-levels. In addition to checks on the main project, on-the-spot checks may be carried out on sub-projects. Projects may also be checked whenever there is considered to be a need for this. Furthermore, if non-compliance with the Regulations is detected in certain projects, on-the-spot checks will be extended to cover similar types of projects. The overall principle is that all projects can be subject to on-the-spot checks.

Regarding the scope of checking, programmes show diverse approaches:

- *100 percent of projects* will be checked in Austria, North East England, Střední Čechy and Wales. In Nordrhein-Westfalen, all projects are checked except for those implemented in the context of a funding block allocated to a service provider (e.g. advice to businesses); in this case, only a sample of service-recipients is checked.

- *50 percent of projects or less* – In Vlaanderen, 50 percent of projects will be checked, and in Finland this will be complemented by checks undertaken based on funding thresholds and for high risk projects (see **Box 14** above); there are also plans to review the percentage during the programme period. Others will check 30 percent of projects (Scotland) or around 30 percent of funding under each Priority (Śląskie ESF). In France, around 20 to 30 percent of projects will be checked based on sampling, while in Slovenia the aim is 25 percent of funding. In Sweden, around 20 percent of projects are targeted with a focus on large projects involving high funding levels. At least 10 percent of projects will be checked in Italy (more for infrastructure projects), and in Denmark plans are to check four to eight percent of projects.

- Some programmes will apply an *'appropriate' percentage*. In Sachsen-Anhalt, this process is closely monitored by the Managing Authority via the electronic system; if substantial errors are detected by an Intermediate Body, the checking must be intensified. The Spanish approach is based on qualitative indicators with samples covering a majority of Priorities and Measures.

Where sampling is used to determine the percentage of checks, this is often organised around some sort of risk analysis. In England, the user manual provides guidance on sampling methods: first, all high risk rated projects are included in the sample; second, 10 percent of the sample is taken from the low risk category to ensure coverage of all project types; third, the remaining balance should be taken randomly from medium risk projects. The size of the sample should be determined by ensuring that reasonable assurance as to the regularity of expenditure can be achieved. The sampling methodology must be reviewed each year. In practice, the RDAs (e.g. North East England, see above) are aiming for full coverage for these on the spot checks. Another example is the Śląskie regional OP (see **Error! Reference source not found.**).

Box 15: Śląskie – Sampling based on risk analysis under the regional OP

In the Śląskie regional OP, all projects involving capital expenditure (public or private investment) must be visited at least once during their life span. Other projects (e.g. advice and promotion activities) are subject to a sampling method. This applies to projects under Measure 1.1. Investment Promotion, some projects in Measure 1.3 Technology Transfer and Innovation, projects in Measure 3.4 Tourist promotion, Measure 4.3 Promotion of Culture and some projects under Measure 5.4 Environmental Management. For all of these projects, responsibility for the checks lies with the Control Unit in the regional development department. The sample is based on a risk analysis of five factors: the size of the project, the duration of the project, the number of partners or other bodies involved, the presence of irregularities, the number of controls and audits previously conducted. This will produce three categories of risk. For 'high risk' projects there will be 100 percent coverage for these checks. For projects of 'medium risk' there will be 25 percent coverage in the sample. For 'low risk' projects there will be 10 percent coverage.

In order to target checks on riskier projects, some programmes have introduced a specific focus. This can be done in several ways, e.g. via:

- a *filter based on project size or duration* - In Nordrhein-Westfalen, more detailed ongoing monitoring is in place for larger projects through a project-specific committee that receives regular progress reports. In Finland, all projects involving €500,000 of public funding are checked (see also **Box 14**). In Wales, several visits are planned for long-term projects with initial visits taking place during the first 12 months of project implementation;

- *risk assessment* - In Sachsen-Anhalt, the Managing Authority has developed a checklist for identifying projects with higher risk. For the Śląskie regional OP, risk assessment is undertaken for non-investment projects, while all investment projects (involving capital expenditure) are subject to on-the-spot checks (see **Box 14** above). In addition to the checks required by the central English Managing Authority, the North East England Intermediate Body has outsourced the work of undertaking pre-assurance visits to risky projects (mainly large projects). These visits will also be available to any organisation on a voluntary basis. In Střední Čechy, ex ante and ex post checks are carried out in addition to interim checks for projects identified during risk assessment in the context of administrative verification; or

- *a focus on strategic bodies* - In Scotland, additional checks will focus on strategic delivery bodies rather than on individual projects by carrying out systems checks before claims submission.

Based on the checks, reports are drafted by some Managing Authorities. In France, appraisal units draft a short report on each control undertaken covering administrative and on-the-spot elements. In Sweden, these are disseminated to all actors to enhance learning.

(iii) Relationship with domestic systems and procedures

In most programmes, systems for both administrative verifications and on-the-spot checks are specific to the Structural Funds programmes rather than covering both EU co-financed and fully domestic interventions.

- For the *administrative verification of projects*, systems are specific to the Structural Funds programmes in Denmark, England, Greece, Poland, Slovenia and Střední Čechy. This is also the case in Portugal, although some verification relies on domestic procedures (e.g. in relation to environmental requirements). In Germany, Structural Funds projects are subject to checks required under domestic rules in addition to Structural Funds checks. Other Member States use procedures which are separate from but similar to Structural Funds mechanisms (e.g. Sweden). In France, administrative controls (*contrôle de service fait*) have existed since 1959 but the Structural Funds approach is more rigorous (e.g. relating to aspects of public procurement, the environment, equal opportunities), although there has been a degree of alignment over time. Issues have arisen in the past in France in relation to the verification of domestic co-financing which has not always conformed to Structural Funds rules.

- *Separate on-the-spot checks* are undertaken for domestic projects in Denmark, Germany and Poland. In some cases, these checks are carried out on an *ad hoc* basis, for example in Finland where an audit firm undertakes these tasks. In France, checks for domestic funds are performed to a lesser extent; if at all, this is generally done ex post while EU requirements are more detailed and demanding. Similarly, domestic checks are not obligatory in Slovenia and Wales. Domestic checks are less systematic or selective in other cases. In the Czech Republic, domestic control mechanisms are not developed in such detail and they are not based on an integrated implementation strategy. In Greece, comparable domestic checks are only undertaken for State aid projects.

However, some overlap can be observed between domestic and Structural Funds approaches to checking. Concerning the Italian Research & Competitiveness OP, Structural Funds procedures for administrative verification are often used for domestic co-financing instruments. Also in Austria, the same procedures are applied for domestic and Structural Funds projects, notably by smaller Intermediate Bodies. Equally, regarding on-the-spot checks, there are some examples of harmonisation between domestic and Structural Funds procedures. In Scotland, certain schemes are subject to similar visits. In North East England, the engagement visits obligatory for Structural Funds projects are also undertaken for domestic projects. Some overlap can also be identified in Vlaanderen, where efforts have been made to enhance coherence between the various rules in place for different types of funding, by facilitating exchange of experience between staff working on domestic schemes and Structural Funds managers. While the authorities in Vlaanderen have not been able to apply the same mechanisms in all cases (e.g. for the ERDF, it is not possible to use estimates for overheads), some Structural Funds procedures have been changed in line with domestic practice (e.g. regarding the depreciation of material costs to relate to the project duration rather than the whole purchase).

(iv) Change from the 2000-06 period

Although in many cases, change from the 2000-06 programme period was limited to adaptations required by the regulations, broader development trends have been noted by some programme managers.

- In the field of *administrative verifications*, efforts can be identified to introduce a more standardised approach, e.g. based on improved guidance (Greece). Also in Sweden, administrative changes and the centralisation of responsibilities have led to greater uniformity of procedures. Others intend to apply a more rigorous approach to checks, such as in Scotland. Generally, it can be observed that a more pro-active approach is now taken towards beneficiaries. In North East England, compliance information is better communicated at an early stage and beneficiary networks are set up to share information on best practice. In other cases, such as in Śląskie, increased pressure is exercised by applying penalties to beneficiaries which do not provide the necessary information, including delaying payment.

- As regards *on-the-spot checks,* some have increased the number of checks to be carried out (e.g. Austria). In Finland, the percentage of projects to be checked is to rise from 40 to 50 percent; at the same time, the threshold for triggering checks has been lowered from €800,000 to €500,000. Also in France, greater importance is attached to these checks and Managing Authorities are requested to undertake more checks. Related efforts are often based on past experience, as in North East England where all projects will be visited because previous samples were unrepresentative. More generally, there is likely to be more comprehensive project coverage in the checks across England, partly to limit the scope for irregularities but also because there are fewer projects to cover. The unit in charge of the Śląskie ESF OP expects there to be a greater focus on large and risky projects.

Perceptions of the nature of checks have also changed, notably reflecting increased awareness of the importance of on-the-spot checks. In Finland, these checks are now seen as closer to auditing than in the past, and the Italian Research & Competitiveness OP has introduced a more tightly defined format for inspections based on central guidance. An increased focus on financial aspects can also be observed in Scotland, and in North East England monitoring and control visits have been strengthened. In Sweden, the centralisation of responsibilities should enhance uniformity in the interpretation of procedures, the lack of which had been found to lead to irregularities in 2000-06.

6.2 The tasks of the Certifying Authority

The tasks of the Certifying Authority are set out in Article 61 of the General Regulation (1083/2006) and focus on the submission of certified statements of expenditure and applications for payment to the Commission. The Certifying Authority must take all necessary steps to ensure that the certified statements of expenditure are accurate and comply with relevant rules.

6.2.1 Certification of statements of expenditure

Expenditure certification is carried out in close alignment with the Structural Funds regulations. Some programme managers take a more structured approach in 2007-13 by using plans and checklists (Sweden) or specific manuals (e.g. Lombardia). A coordinated approach is used in Austria, where certification procedures have been agreed in the working group of all Managing Authorities. Organisational procedures are sometimes adapted to different project types. In France, an initial check on information gathered on payment declarations in the database and on Article 13 reports (Regulation 1828/2006) is followed by a second quality-control certification for certain projects; for these, there is an addition check on payment documentation. This is not done systematically but is based on a sample which is determined by the Certifying Authority.

6.2.2 Sources used

As a basis for checks and risk analysis, a wide variety of sources is used. First, Certifying Authorities mainly draw on general material provided by programme implementers, such as:

- Managing Authorities, which provide extensive information for the Certifying Authority's checks (Denmark, England, Portugal, Slovenia). In Sweden, the programme support office within the Managing Authority ensures that the Certifying Authority receives the necessary information. The Flemish Certifying Authority bases its work on the results of checks performed by the Managing Authority's financial unit. In the Czech Republic, the Managing Authorities and their finance units provide documents on the procedural findings of the implementation of all OPs;

- Intermediate Bodies involved in Article 13 checks forward summary reports to the Certifying Authority (Sachsen-Anhalt);

- Monitoring Committees – in the Czech Republic, the Certifying Authority attends Monitoring Committee meetings for all OPs;

- Applicants – annual credit certificates are required from sponsors in Wales.

Second, reports produced at different levels of checks are an important source of information. These are frequently prepared on Article 13 checks (e.g. France, Sweden). In Wales, quarterly reports on detected errors are produced by the Projects Inspection and Verification team of the Welsh Managing Authority. Reports produced by the Audit Authority are also used as one of the main sources of information in Denmark, England, Wales, Slovenia and Sweden. In the Czech Republic, a wide variety of financial control reports is used, such as internal audit plans, reports on the findings of Managing Authority audits, annual control reports, reports on irregularities, Monitoring Committee and Audit Authority reports). In Portugal steps are taken to ensure that the negative findings of previous reports have been satisfactorily addressed.

Third, Certifying Authorities use databases to reinforce their checks (France, Spain, Sweden). Some databases carry out automatic plausibility checks (Austria), store record payment data (Austria) or show outstanding parts of the payments process and related variations (Wales). They can also generate expenditure certificates and statements of expenditure (Austria).

Using the example of Lombardia, the different steps and inputs involved in the certification of expenditure are summarised in **Box 16**.

Box 16: Lombardia – Steps for the certification of statements of expenditure

The Certifying Authority within the Presidency of the Region receives a summarised declaration on expenses from the Managing Authority. In line with the Regulations, it first checks that the declaration is correct, draws on reliable accounting systems, and is based on verifiable justifying documents; and second, that expenses declared conform with Community and national rules, and that expenses relate to operations selected for financing under the programme and in line with EU and domestic rules. The checks are carried out mainly through the regional Information System which has data on:

- expenses certified by the beneficiary and verified by the Managing Authority or Intermediate Body;
- expenses made by the Region Lombardia or an Intermediate Body to a final beneficiary;
- the results of relevant controls (e.g. Article 13 checks);
- the recovery procedures activated and the amounts recovered;
- any irregularities communicated;
- any requests for financial corrections received by the European Commission.

Based on these checks two reports are produced and stored in the database: the Report of the Detail of Expenses and the Control Report. The Certifying Authority then drafts the expenditure declarations and payment claims to be sent to the Commission via the National Body for the Coordination of the Transmission of Payment Claims and copied to the General Accounting Office (IGRUE). It utilises a specific reporting model for the certification of expenditure (based on different types of controls for different types of operation) and the model provided in the Regulations for expenditure declarations and payment claims.

Source: Manual of the Certifying Authority, June 2008

6.2.3 Change from 2000-06

In some cases, no major changes to certifying activities can be identified as compared to the 2000-06 period (Czech Republic, Nordrhein-Westfalen, Sachsen-Anhalt, Spain). Others see a greater emphasis on financial control due to by EU requirements (Finland) and an increase in the responsibilities of the Certifying Authorities (France, Sweden, Wales). In a number of programmes, the separation of roles between Managing and Certifying Authorities has been better clarified (Denmark, Italy Research & Competitiveness OP, Vlaanderen, Wales; see Section 5.1.1). New procedures have also been introduced in line with past experience, notably based on audit findings. In Vlaanderen, for example, the Paying Authority in 2000-06 was found not to have carried out enough checks and procedures relating to risk analysis, and checks have been changed accordingly. Austrian programme managers expect procedures to become more formal and time-consuming, notably regarding changes in reporting formats required by the Commission. Furthermore, an increase in the level of information required from the Managing Authority is observed in Scotland.

Approaches are also becoming more preventive and forward-looking, often in line with improvements in databases. In this context, widespread action has been taken to improve audit trails in Greece. In Wales, the Certifying Authority keeps a record of all audits, including recommendations and management responses. Here, efforts are made to follow-up on related developments to avoid future problems. Also, communication between the Managing and Certifying Authorities is encouraged in order to raise relevant issues and to allow for timely programme closure. Additionally, a number of programmes have built in additional checks at different stages of the financial management, control and audit system (see **Box 16**).

Box 17: Examples for enhanced quality control – 'auditing the auditors'

In a number of programmes, additional controls are built into the systems at different stages. This is to make sure that the system in place is correctly managed and can help detect systemic errors.

In **France**, quality control can be carried out by the Europe units of the *préfet*'s secretariat (SGAR) on the audit trail. This is based on meetings with the appraisal units to check whether all the necessary documentation is gathered. This form of internal audit involves a precise methodology using non-statistical samples that determine the selection of appraisal units by the Managing Authority.

Additional system checks are also carried out in **Nordrhein-Westfalen** by the Office for Quality Management in the *Land*'s Bank. This takes the form of a sample check of around 20 percent of projects, involving both desk and on-the-spot checks.

In the **Czech Republic**, on-the-spot checks of the implementation of management processes and control systems will be carried out by the Certifying Authority on Managing Authorities and their finance units and on Intermediate Bodies.

Similarly in **Portugal**, on-the-spot checks will be undertaken if necessary to ensure that projects are selected in accordance with programme criteria; that expenditure declared has actually been incurred and complies with Community and national rules; that an adequate audit trail is apparent in accordance with Regulation requirements; and that irregularities are prevented, detected, and the necessary correcting measures are taken. Other examples can be found in Scotland and Slovenia.

6.3 The tasks of the Audit Authority

A major innovation of the 2007-13 period has been the institutionalisation of a dedicated body in charge of auditing activities, whose tasks are outlined in Article 62 of the General Regulation (1083/2006). In the past, this role has been fulfilled by delegation of the Managing Authority and the main task has been the declaration on the winding-up of assistance at the end of the period (Regulation 438/2001, Article 15). The following sub-sections focus, first, on changes in the role of the audit body in 2007-13, and then on the core tasks of the Audit Authority, namely the compliance assessment, the Audit Strategy, and the annual control report and opinion to the Commission.

6.3.1 Lessons learnt and changes in the role of the audit body

In many Member States and regions, the body in charge of the winding-up declaration in 2000-06 also acts as the Audit Authority in the 2007-13 period. This is the case in Austria, Denmark, England, France, Greece, Italy, Portugal, Slovenia, Spain and Vlaanderen. In other cases, however, new bodies are in charge of auditing activities, notably where tasks had been carried out in proximity to the Managing Authority in 2000-06 (Finland, Sweden, Wales) or where work had been previously outsourced to a private company (Nordrhein-Westfalen, Sachsen-Anhalt). Whereas for Nordrhein-Westfalen, it appeared to be less expensive to involve a unit in the Finance Ministry, Sachsen-Anhalt's Audit Authority will continue to be supported by a private sector auditor.

At the time of fieldwork, activities concerning the winding-up of assistance in the 2000-06 programmes were still limited, but some lessons can be identified for the 2007-13 period. Programme managers notably found it important to invest in related activities early in the period. The early provision of guidance to project holders is seen to be important in Wales in order to avoid problems; in this respect, the situation is felt to have improved for 2007-13. The usefulness of databases as support tools for information storage is also noted (France), and related developments in 2007-13 are reflected in a number of programmes.

Despite continuity in the entity acting as the audit body in the majority of Member States and regions, its role is seen to have changed fundamentally. This is mainly linked to the fact that the Audit Authority will have to carry out a much wider variety of tasks throughout the 2007-13 period, leading to a considerable increase in responsibilities (Austria, France, Vlaanderen). Overall, the overall approach of the Audit Authority are seen to be more formalised, e.g. with respect to the need to audit risk and the development of new methodological approaches (Slovenia). On the other hand, the more formalised approach is perceived as beneficial in terms of clarifying what is considered as best practice (Finland).

The role of the Audit Authority within the broader institutional context also seems to have evolved. It is seen to be linked more directly with the European Commission and other EU institutions, leading to concerns that this could result in tensions with other programme authorities (France). The Audit Authority's position is also seen as ambivalent in that, on the one hand, it needs to gain the Commission's trust while, on the other hand, Member State authorities might perceive it as acting on behalf of the Commission. It is foreseen that tensions could potentially arise if expenditure approved by or for other public authorities were to be declared ineligible (Wales). In line with these developments, scrutiny by external auditors (both at domestic and EU level) is likely to tighten (England). Ethical standards are expected to be high, especially for those having signed a contract of confidence with the Commission's Fund DGs in 2000-06 (Wales).

6.3.2 Compliance assessment 2007-13

At the time of fieldwork, most of the descriptions of the management and control systems were still under development (Italy R&C OP) or in the process of being checked by the Audit Authority (Denmark, Finland, France Greece, Vlaanderen, Wales). Some of the programme managers had already sent their systems' description to the Commission and had received a first response. While in the case of Nordrhein-Westfalen, remarks were only minor and it was hoped to receive final approval by mid November 2008, the description was declared not receivable in the case of Lombardia because the eligibility rules had not yet been approved nationally. In a limited number of cases, such as Slovenia, the descriptions had already been approved. In Austria, three out of eight descriptions for the C&E Objective had been accepted, including Niederösterreich.

(i) Organisation

In most cases, the compliance assessment was carried out internally by the Audit Authority (Czech Republic, Denmark, England, Finland, France Greece, Italy, Nordrhein-Westfalen, Portugal, Sweden, Vlaanderen, Wales) with outsourcing only used to a limited extent. The exercise was mainly based on documents provided by the Commission (i.e. checklist, work programme, guidance notes, questionnaire) (Czech Republic, Finland, Slovenia, Sweden, Wales). In addition, meetings were carried out in some Member States. In Portugal, a round of meetings was organised by the Audit Authority, bringing together all organisations involved in managing and control systems. The Austrian Audit Authority organised an informal meeting with Managing Authorities to discuss drafts of systems' descriptions; generally, ongoing contact between the authorities was maintained with the aim of ensuring a consistent approach. Interviews with the main relevant actors were also undertaken by some Audit Authorities, such as in Lombardia and Wales. In Wales, an official opinion was also provided by the Welsh Assembly's legal department.

In some cases, the process was divided into a number of stages. In the Czech Republic, the actual assessment was preceded by a pre-compliance assessment undertaken in the form of a conformity audit. Financed by Technical Assistance, the Audit Authority examined individual Intermediate Bodies and analysed documents (e.g. operational manuals, internal methodological guidelines). The aim was to ensure completeness of information and to address issues at an early stage, and this process led to several changes in the implementation system. The audit was repeated to assess whether identified imperfections had been removed. Similarly, in England, a pre-compliance assessment was followed by a full-scale assessment in every region. An iterative approach between the Audit Authority and the Managing Authority was adopted in Nordrhein-Westfalen.

The coverage of compliance assessments varied. The Austrian Audit Authority extended the assessment to all Intermediate Bodies in order to avoid amending the systems' descriptions during the approval process at EU-level. For the Sachsen-Anhalt compliance assessment, all budget lines and intervention types were covered, based on checks of descriptions of what would be financed under each budget lines, as well as checks of audit trail forms setting out the administrative tasks to be undertaken; this was followed by checks on the description of the central system and all its constituting bodies as well as the electronic data monitoring system. This process led to minor changes, e.g. based on additional information provided by some Intermediate Bodies.

(ii) Experiences of programme managers

The drafting process of the compliance assessment was seen as challenging by some programme managers. In Finland, it was perceived as a very bureaucratic exercise and difficulties were met in developing an overview of the fragmented ERDF system. Delays during the approval process were felt to be problematic, notably in Austria. Issues mainly arose due to high workloads in Managing Authorities and the need to provide extensive documentation (Nordrhein-Westfalen). For others, the process was less of a problem, for instance because there was experience with similar procedures on the domestic side (Sweden). While the assessment is expected to entail changes for some programmes (Spain), others do not expect major changes (Denmark).

In some cases, the process was considered to be rather beneficial, especially from a control viewpoint (Greece). In Wales and in Scotland, it was seen to be important to have early checks which could mean that fewer audits would need to be undertaken by the Commission. Programme managers in North East England viewed the exercise as a good testing tool. Also in the Czech Republic, the compliance assessment was perceived as a useful tool by the Audit Authority and helpful for the Managing Authority. Beneficial adjustments were also made in Portugal based on a participatory process. In Austria, the higher degree of formalisation of actor relations and increased certainty of procedures were identified as positive outcomes of the demanding requirements. Enhanced discipline and improved timing were also observed in Slovenia.

6.3.3 Audit Strategy

One of the main tasks of the Audit Authority, besides the compliance assessment, is the drafting of an Audit Strategy, specifying the involved actors, the methods to be used and the indicative planning of audits. At the time of fieldwork, a number of Audit Authorities had submitted a first version of the strategy to the Commission (Czech Republic, Italy R&C OP, Slovenia) and some had already received first comments (e.g. Austria). In Sweden, the work on the comments is ongoing as the required information is more detailed than expected. Also, Austrian and Slovenian authorities felt the exercise to be rather demanding. The Danish Audit strategy had to be changed marginally following Commission feedback. Other Audit Authorities had not yet formally submitted their strategy (e.g. Sachsen-Anhalt).

Different approaches were taken to the coverage of the strategy. Some Audit Authorities decided to draft a single strategy for several OPs to ensure consistency. In Finland, for instance, all mainland OPs were addressed by the same strategy, and in Austria workload was minimised by covering all OPs except for the Vienna C&E OP; this should also allow representative samples to be drawn. In other cases, individual strategies have been drafted (Germany, Italian R&C OP). Although Czech Republic had initially planned to submit a joint strategy for all regional OPs, this proved not possible due to considerable differences between the programmes. Similarly in Poland, every regional Revenue Office has its own Audit strategy. In Lombardia and Sachsen-Anhalt, the strategy covers both ERDF and ESF OPs.

As with the other processes, the steps taken to draft the strategy and the strategy content are mainly in line with EU Regulations and guidance (Austria, Sweden, Wales). They are also based on past experience (France), the compliance assessment, and domestic and international audit standards (England, Greece, Sweden). In England, a targeted support group was set up. Where programmes have many Intermediate Bodies, as in Sachsen-Anhalt, the main focus was on documenting the sample checks and the Intermediate Bodies' systems. Whereas in Denmark there are plans to increase the share of audited projects, fewer controls are expected in France, however within shorter delays and stricter follow-up.

The bodies consulted on the strategy were mainly internal to the management and implementation system. In Finland, comments were received from internal auditors, and in Sweden the Audit Authority team was consulted. In Nordrhein-Westfalen the Managing Authorities were consulted during the exercise, and in France the Certifying Authority was also consulted. Similarly in England, the drafting was carried out in partnership with representatives from Certifying and Managing Authorities as well as Intermediate Bodies. In Wales, the draft strategy was presented to the government committees of the Department for Economy and Transport and of the Principal Accounting Officer for approval; the annual audit plans and the updated strategy will be subject to similar procedures. In Slovenia, the strategy was furthermore presented to the domestic Court of Auditors. Some Audit Authorities also drew on consultancy input, e.g. with respect to sampling methods (Austria, Denmark, Sachsen-Anhalt).

6.3.4 Annual control report and opinion to the Commission

Progress is also being made on the drafting of the first annual control report and opinion to the Commission. This task is underway in England, Slovenia and Sweden while some Audit Authorities have not started yet (e.g. Portugal). In Finland, related adjustments are being made to the electronic system, and audit checklists and reporting templates are being prepared. Input is expected to be received from the Managing Authorities (e.g. France); in Sweden, this is hoped to contribute to broader audit-related learning. Consultations are also planned, e.g. with the private auditor (Sachsen-Anhalt), heads of division, committees and the Permanent Secretary (Wales) and delegated audit entities (Czech Republic).

The content of the first annual report is expected to be limited since the programmes are still in the starting-up phase, and commitments and payments are limited (Austria, Czech Republic, Greece, Sachsen-Anhalt, Wales). The main points to be covered will therefore relate to activities carried out on the systems' description, the compliance assessment and the audit strategy. Moreover, as the systems' descriptions have not yet been approved in many cases, the content remains provisional.

6.4 Summary

Although the Structural Funds regulations in 2007-13 clearly stipulate the core activities and roles of the Managing Authorities, Certifying Authorities and Audit Authorities, there is still considerable scope for Member States and programme managers to take different approaches to the key tasks of these authorities. Moreover, the experiences and perspectives of Member States in relation to these tasks vary widely.

Many programme managers found the work of drafting the descriptions of the management and control systems to be onerous in terms of time and resources, although some noted that this was also the case in 2000-06, and others noted that this exercise had brought benefits. Key concerns related to the work need to respect the obligation to update the descriptions on an ongoing basis. Managing Authorities are taking different approaches to administrative verifications and on-the-spot checks (e.g. in terms of sampling and risk assessment). There are also differences in terms of interactions with domestic rules on project checks, with a degree of overlap or duplication in some Member States. In a number of Member States, there is a more rigorous approach to either administrative verifications or on-the-spot checks than was seen in 2000-06.

Although the work of the Certifying Authorities in some Member States is not seen to have significantly changed in 2007-13 compared to the work of the Paying Authorities in 2000-06, in other cases there is evidence of a shift towards a more rigorous approach. This is not only due to the new regulations (e.g. in relation to the separation of functions) but also to the results of past Commission audits.

The most significant changes in 2007-13 are perhaps seen in relation to the Audit Authority, which has considerably more responsibility than in 2000-06. Even where the entity in charge of the declaration on the winding-up of assistance in 2000-06 is also the Audit Authority in 2007-13, changes have been introduced due to this increase in responsibilities. Opinions of the usefulness of the compliance assessment vary, with some programme managers arguing that it is very bureaucratic and creates an unnecessary workload, but others noting benefits such as greater certainty of relations and procedures. At the time of fieldwork, few programmes had received Commission approval of either the compliance assessment or the Audit Strategy. Some voiced concerns over the additional work and time involved in addressing Commission comments and requests for information.

7. PERSPECTIVES OF PROGRAMME MANAGERS

7.1 The evolution of Structural Funds requirements until 2007-13

There is a broad degree of awareness amongst programme managers of the increased weight of financial management, control and audit requirements in the current Structural Funds regulations. The general view among those managers interviewed is that requirements have grown from one programme period to the next, mainly in response to political pressures and increased emphasis on the efficient and effective use of Structural Funds across the EU, at both EU and national levels. In some cases, such as in Scotland, the evolution of EU requirements is mirroring a similar trend for more stringent procedures in domestic policies. Some managers noted that 2007-13 requirements essentially formalise what was being practised and required by the European Commission during the 2000-06 period, but was not explicitly specified in the 2000-06 regulations.

In some countries, EU rules are considered to have generated a gradual cultural change with respect to financial management over a number of programme periods. For example, in France, the approach taken to financial control in 1994-99 was counter to that recommended by the Commission: there was no ex ante control of projects and this led to a very high irregularity rate detected ex post. Over time, however, the preventative approach fostered by EU requirements has taken over. Similarly, in Greece and Italy, the experience of implementing EU rules has led to a change in mentality as to the appropriate way to manage resources, and has raised awareness of the need to prevent irregularities and fraud.

There are some positive views of the new generation of Structural Funds regulations, particularly because requirements are more clearly spelt out from the outset this time. For instance, some programme managers mentioned that Article 4 of Regulation 438/2001 on project checks was difficult to understand, whilst Article 13 of Regulation 1828/2006 is much clearer. However, this greater clarity is sometimes seen as contributing to the increase in the administrative burden on administrative authorities.

Amongst the main changes that are viewed favourably by programme managers are the allocation of a strengthened role to national auditors and the faculty attributed to national governments to decide on eligible expenditure. These changes are viewed as improvements that can contribute to the more effective delivery of programmes.

However, programme managers' views on other changes are more mixed. For example, some approved of the introduction of a contractual relationship between Managing Authorities and Intermediate Bodies, as this is seen to provide more clarity on respective roles and obligations (Italy OP R&C). In contrast, others (e.g. Austria, Germany) have found that this contractual approach conflicts with domestic systems, especially where cooperation is already seen to work well on the basis of less formal relationships, or where Intermediate Bodies are not subordinate to the Managing Authority in domestic structures (e.g. where both the Managing Authority and Intermediate Bodies are units in sub-national administrations).

The availability of additional guidance – particularly from COCOF – is seen to have been beneficial in clarifying interpretative questions or open issues. However, a number of programme managers interviewed note that there are still issues in the current regulatory framework which are open to interpretation - e.g. the treatment of staff costs, overheads and flat-rate costs, and the issue of revenue-generating projects (Czech Republic, France, Lombardia, Niederösterreich, Vlaanderen, Wales) - and that guidance should have been made available more readily.

There are also aspects of the new regulations that raise concern amongst all programme managers, notably the overall weight of the administrative burden associated with the programmes, which is often seen as disproportionate, either in financial terms or in administrative terms.

Additional concerns relate to specific aspects of the regulations. For example, some managers argue that the stipulation in 2000-06 that at least five percent of eligible expenditure had to be checked before the winding-up declaration (Regulation 438/2001, Article 10) was more helpful than the 2007-13 emphasis on the need to undertake an adequate sample, with larger samples needed if the Audit Authority finds systemic problems (Regulation 1828/2006, Article 16). This apparent greater leeway in 2007-13 for domestic Audit Authorities to decide on the appropriate level of samples places greater responsibility on domestic authorities to ensure that sufficient checks are undertaken.

7.2 Views on internal audit as a preventative approach

The programme managers interviewed broadly have positive views of the Commission's emphasis in 2007-13 on enhancing internal, preventative audit processes, and on audit as a learning process, even though this approach is seen as building on past experience rather than as a radical new innovation. There is, however, some scepticism regarding the actual potential of audit to become a genuine learning process, especially when audit visits are carried out at the end of a programme period and emphasis is placed on punitive rather than supportive actions.

Programme managers see a number of perceived advantages to a preventative approach:

- First, internal audit maximises insider knowledge and is considered to be less costly and more flexible than external audit (Czech Republic, Denmark, Finland, France, Slovenia, Wales). It is also considered a better approach for feeding audit results into processes in a more timely manner than is external audit. Thus far, the length of time between the undertaking of an audit, its results being known and potential financial corrections being undertaken has been lengthy (even several years) and the new emphasis on internal audit should help to overcome this problem (País Vasco, Portugal, Wales).

- Second, internal audits can help to encourage learning, so that audit visits do not simply aim to uncover fraud or irregularities, but act as useful tools to identify problems and solutions. This shift in the outcome of the audit activity from financial clawback to support can contribute to improving the effectiveness of internal control systems (Kentriki Makedonia, Czech Republic, Lombardia, Portugal, Wales). The approach of preventing rather than combating irregularities and fraud is considered to be an appropriate strategy for maximising the effectiveness of programmes.

- Third, whilst external audits have often been demoralising for programme authorities and beneficiaries alike, the formative dimension of internal audit can act as a motivating factor which can enhance staff performance and thus contribute to increasing the quality of programme management.

- Fourth, placing greater emphasis on risk assessment and risk management makes auditing activities more targeted and relevant, focussing where the risk is greater and thus easier to accept (Finland, Scotland).

- Lastly, thanks to its increased preventative dimension, internal audit lends itself to higher 'ownership' by domestic partners. As is the case with evaluation, this is likely to enhance the potential for the recommendations of audit inspections to be effectively and readily followed-up. There may be also multiplier effects, in the sense that recommendations related to the flaws or deficiencies found in the managing and control systems of a programme could also be used to benchmark or support other programmes within the same country (Portugal).

There are, however, a number of obstacles that might prevent the effective implementation of the desired internal audit approach. First, implementing this approach will require a change in mentality and culture amongst all those concerned (Lombardia, Sweden). Audit is still largely perceived to be oriented to the detection of irregularities and fraud, with the Audit Authority sometimes seen to act on behalf of the Commission.

Second, time is needed for learning to turn into action, and that audits cannot instantly affect existing procedures and processes (Denmark). Related, it is important to time internal audits appropriately, as it is not useful to carry these out at the end of a programme period, when there is no scope to intervene to correct mistakes (Sachsen-Anhalt, Scotland, Vlaanderen). In the past there have sometimes been closure audits which have not been useful in terms of supporting programme implementation and simply resulted in a distorted image of the programmes' actual efficiency or achievements.

Finally, EU rules which set a maximum material error rate of two percent are seen as likely to undermine the potential of audit activities to become real learning tools (Wales). There are concerns that such a low permitted error rate may deter national and regional authorities from being more open and frank about financial irregularities because this is likely to raise the error rate.

7.3 The effects of the focus on financial management, control & audit

The strengthened financial management provisions of the new regulations present both positive and negative implications for programme managers. They are discussed in turn in the two following sub-sections.

7.3.1 *Positive effects*

(i) Less scope for bad surprises later in the day

Amongst the most important positive effects anticipated is the fact that the new rules are seen to limit the scope for unpleasant surprises at later stages of programme delivery, by providing a more stringent and ex ante defined framework of binding procedures and controls (e.g. Denmark, Scotland). The financial management systems resulting from the new requirements are expected to be more robust and able to reduce error rates significantly (País Vasco). Overall, the increased focus on financial management, control and audit is expected to improve the quality of implementation (e.g. Czech Republic, Greece, Sachsen-Anhalt).

(ii) Positive spillover effects on domestic systems

In the new Member States, particularly in the Czech Republic and Poland (Śląskie) and also in Greece, given the relatively high percentage of EU Cohesion policy resources in total domestic policy funding, the increased attention on financial management, control and audit is having a considerable positive spillover effects on domestic systems. A generic learning effect was also reported in Slovenia, Denmark and Wales, where Structural Funds rules have led organisations involved in Structural Funds' programmes to develop skills, capacities and experience which may spill over to the domestic policies or programmes that they administer. In Wales, where Structural Funds' rules are stricter than domestic rules and the consequences of non-compliance are more severe, the implementation of EU programmes is seen to have reinforced domestic financial management and control systems. In addition, the experience developed thanks to the EU requirements is shedding light on the inaccuracies or inadequacies of domestic legislation and systems (e.g. in the Czech Republic, Sweden), inspiring domestic actors to improve national rules, which has positively affected the quality of domestic systems.

Box 18 The description of the management and control system

A number of programme managers (Austria, Czech Republic, Finland, France, Nordrhein-Wesfalen, Poland Scotland, Sweden) note some positive views on the requirement to gain Commission approval for a description of a programme's management and control system, including:

- a more strategic approach to programme delivery and financial management since all implementation steps are set out in detail from the beginning of the period;
- a higher level of certainty in relation to the procedures of Intermediate Bodies;
- legal certitude *vis-à-vis* the European Commission;
- prevention of problems which might otherwise only emerge through ex post controls;
- ensuring that project sponsors show financial and procedural discipline;
- enabling learning among authorities involved in programme coordination and implementation, contributing, *inter alia*, to increased accountability;
- preservation of institutional memory, which is particularly crucial (i) at the end of a programme period, if staff move on; (ii) if there is extensive institutional reorganisation and (iii) if there is high staff turnover in the public administration.

However, some programme managers (Austria, Lombardia, Nordrhein-Westfalen) also identify various negative effects, namely:

1. the amount of work required to prepare such descriptions, which has reduced resources for programme implementation, and in some cases has led to delays in the launch of programmes, with possible implications for compliance with n+2 rules;
2. the time and resources likely to be absorbed in up-dating the description, as required by the regulations.

7.3.2 Negative effects

There are also a range of negative effects or potential difficulties associated with the increased emphasis on financial management, control and audit in the new regulations.

(i) Burdensome administration

The main negative effect of the new EU regulatory framework is seen as the burdensome character of the administrative requirements entailed by EU rules. According to the programme managers interviewed, this has a number of detrimental effects on the effective management and delivery of programmes. First and foremost, setting up and running the new financial management systems is extremely resource-intensive and this causes problems, not least given the constraints placed upon domestic budgets in a number of Member States and regions. The sustainability of requirements is questioned by many programme managers, particularly given that, whilst administrative obligations have steadily increased, the financial and human resources devoted to the administration of many programmes have at best remained static. Moreover, even countries and regions which have seen a significant reduction in EU funding in 2007-13 have needed to maintain relatively high staff numbers in order to deal with the increased administrative burden.

Additionally, whilst the quality of financial management, control and audit systems is considered to be improving as a result of the more stringent regulations, it is also the case that the additional administrative burden is seen to have a negative impact on the time needed to process applications and administrative documentation, expanding the timetable of selection procedures and payment claims processing (e.g. in Sweden). Related, the heavy administration associated with Structural Funds programmes entails the risk that, instead of focusing on project results and impacts, the focus will be on detailed administration and financial control (Länsi-Suomi, Scotland). As a result, there are concerns that, although the current approach to financial management, control and audit has a positive effect on the quality of Structural Funds management in itself, this is at the detriment of the main goal of programmes, namely the development and implementation of projects that contribute to socio-economic development (France, País Vasco).

(ii) Stricter or greater requirements than in domestic systems

Structural Funds financial management, control and audit requirements are often stricter than those of domestic schemes (e.g. in the Czech Republic, Denmark, Finland, Vlaanderen, France, Kentriki Makedonia, Slovenia, England) and, as a result, both recipients and Intermediate Bodies may find domestic schemes more appealing than those co-financed by EU Cohesion policy. This means that there are concerns that potentially good projects will not be implemented under the EU co-financed programmes, or that some organisations (including those with a good track record of project delivery) may opt out from the programmes (e.g. Länsi-Suomi, Scotland).

In addition to this displacement effect towards domestic schemes, there are concerns that the rules on financial management could discourage some projects that are in principle closely aligned with the aims of the programmes. In Slovenia, for instance, the administrative burden imposed on Structural Funds programmes is seen to favour larger projects and this could have detrimental effects on some kinds of innovative projects. In Greece, the need to comply with financial management, control and audit rules is leading to the selection of projects that are administratively and technically more mature, even though these may not always be the ones closest to the programmes' objectives. However, the changing emphasis of programmes is not seen to be solely or necessarily driven by control and audit concerns, as it can instead reflect more substantial considerations about the appropriateness of policy aims and instruments. In Denmark, programme managers noted that despite the less extensive requirements of domestic schemes, Danish authorities are continuing to insist on multi-partner projects under the EU co-financed programmes, despite the fact that these are more complicated and risky than single-partner projects.

Nevertheless, it is not universally the case that EU Cohesion policy financial management, control and audit requirements are stricter than their domestic counterparts. In Germany, for example, the two systems are seen as different in philosophy and approach but as equally demanding. Such a situation can engender difficulties. Some of the difficulties experienced in the financial management of some German programmes are due to the complex interactions between the two approaches. For example, EU funding is often used to co-finance projects under domestic schemes which have separate sets of administrative checks on projects, so that Intermediate Bodies must undertake both EU and domestic checks.

(iii) Increased onus on final recipients

The new approach emphasises the responsibilities of recipients in organising and maintaining correct financial records and audit trails. However, this may be undermined in some programmes by a lack of appropriate skills among recipients. In Śląskie, for instance, many beneficiaries do not have the necessary experience in developing applications, for example because they have relied on consultants or have based their applications on other applications in the past. Moreover, some applicants have a limited understanding of the financial management requirements of EU funding. In some programmes, there is therefore a need for more extensive investment in training and capacity building for project applicants and beneficiaries.

On the other hand, where project holders are well aware of EU requirements, this may lead to a degree of frustration or scepticism. In Slovenia, project applicants, particularly from the private sector, are often frustrated with current requirements which they perceive to be overly demanding. This is exacerbated by a lack of consultants with sufficient experience to provide the necessary advice and support. In North East England, some kinds of potential applicant, such as higher education bodies, are seen to be sceptical and wary of involvement in the Structural Funds programme. The Regional Development Agency (ONE North East) is working hard to overcome this scepticism, by developing guidance and providing advice on technical aspects of project applications.

One final aspect of the regulations which may be off-putting for beneficiaries relates to the risk of being subjected to extensive auditing, particularly where domestic systems are less strongly reliant on audit. Project holders who have been badly affected by past audits are often reluctant to become involved in the new programmes.

(iv) Interplay between domestic and EU systems

A final point worth considering in discussing the negative implications of the new EU regulatory framework is that a distinction should be made between the direct effects of EU requirements (such as the issues discussed above) and the impact of domestic interpretations, adaptations or applications of EU rules. In Italy, for example, Commission approval of the descriptions of the management and control systems has been suspended due to significant domestic delays in finalising the domestic regulation on eligible expenditure. Pressure to start allocating funds has, however, led to the publication of calls for tenders and the commitment of some resources – so that Managing Authorities will have to deal with the consequences of any incorrect application of the (yet to be decided) eligibility rules. In Finland, the Ministry of Employment and the Economy has provided extensive additional guidance to the regional authorities in charge of managing the programmes. However, many regional level-actors in the programme of Länsi-Suomi feel that there is currently an overload of guidance from the Ministry to the regions, indicating the need to find a more appropriate domestic balance on the amount of guidance provided. Lastly, in Austria, there is political will among domestic authorities to fund smaller projects, even though EU rules are seen to entail a bias towards larger ones. However, this focus on smaller projects is generating considerably more work for Intermediate Bodies and Managing Authorities.

These examples indicate that, whilst EU rules present a wide array of potential problems for programme managers, Intermediate Bodies and beneficiaries alike, it is often the interplay between domestic and EU systems that causes many challenges. In a number of Member States and regions, the EU framework or specific aspects of the EU regulations are not coherent with domestic systems or legislation (e.g. in Czech Republic, Denmark, Germany, Italy). This can generate considerable problems for the implementation of EU rules. For instance, in the Czech Republic the multi-annual financial management of EU programmes clashes with the annual approach of the domestic budget, and this can have repercussions on payments to final beneficiaries, thus affecting the projects' completion schedule. Similarly, in Denmark and Italy, the EU requirement on beneficiaries to retain documents related to co-financed schemes for three years after the Commission's final payment to the programme is potentially problematic: first, because it is not in line with domestic schemes and second, because this deadline is a relative, rather than an absolute, goal. This is having repercussions on the closure of the current programmes.

7.4 Views on the need for change

As the new regulatory requirements on financial management, control and audit are seen to have a number of negative effects, programme managers argue for a number of changes to Structural Funds rules and systems. A number of issues are here discussed briefly in turn.

Box 19: Austria's Audit Authority

In the Commission's Open Days event in Brussels on 7-9 October 2008, Susanna Rafalzik of Austria's Audit Authority (Federal Chancellery) argued that there was room for improvement in the following areas:

- Creation of a stable and secure legal framework with no changes in rules or retro-active application of new rules;
- Reduction of inherent risk via clearer and simpler rules;
- More modest expectations of projects;
- Awareness that high-risk projects and programmes cannot be implemented with the current tolerable risk rate;
- Consideration of more use of flat-rate funding for some types of expenditure;
- Enough qualified human resources;
- More political efforts to reduce potential conflicts of interest;
- Clarify politically that tolerable risk does not mean fraud and misuse;
- Political discussions of the cost-benefit ratio of control.

7.4.1 The need to build capacity at all levels

As rules on financial management, control and audit have become more complex, there is a need for improved human resources and better coordination at all levels: from the Commission, to the national and sub-national authorities that manage the programmes, to the beneficiaries involved.

There have been extensive efforts in virtually all programmes to build capacity by equipping the relevant authorities with the skills and knowledge necessary to respond to the challenging financial management tasks at hand. In some cases, these efforts have included the creation of exchange fora and other ongoing forms of cooperation. However, further efforts are needed to ensure the availability of necessary skills in some cases, not least at the level of final beneficiaries. Similarly, enhanced coordination and cooperation could be fostered amongst the bodies involved in Structural Funds management in each country and region. There may also be scope to enhance the exchange of experience between Member States and programme managers at EU level.

Programme managers also suggest that there is a need to develop further the skills of some Commission staff. Some note that Commission desk-officers are not always able to answer practical questions or to understand implementation problems that may derive from local conditions or legal frameworks. Similarly, concerns were raised on the skills of some EU auditors. Although clear efforts have been made to improve coordination between Commission DGs (especially DG Regional Policy and DG Employment), there may be further scope to improve coordination and communication in order to ensure coherence between the ERDF and the ESF.

7.4.2 The need for timely, clear and definitive rules and guidance

Many of the programme managers have noted that a key source of uncertainty has been the relatively late adoption of EU regulations, as well as delays in publishing guidelines or interpretative clarifications. The absence of clear rules from the outset of the programme period can have a detrimental impact on the programmes' ability to deal with the new requirements, especially as EU rules need to be integrated into domestic administrative contexts which often cannot be changed at short notice.

The stability of the rules in force is also critical. Some managers note that Structural Funds rules have in the past been amended or re-interpreted during a programme period and that this has led to significant problems.

Moreover, Structural Funds regulations and guidelines are seen to have introduced innovations whose implications have not been adequately assessed or which have run counter to the lessons learnt from past implementation. Learning is an incremental process and understanding new requirements and their application can require time. Some programme managers argue that, in future periods, it would be more efficient to take an incremental approach to the re-drafting of the regulations, aimed at amending Articles which have proved problematical, rather than at fully revising all aspects of implementation.

7.4.3 The need for more clarity and better communication

There are a number of concerns amongst programme managers on EU rules that are not clear or not easy to interpret. Questions were raised on issues such as: what constitutes an irregularity; how to sample operations for on-the-spot checks; the percentage of projects that need to be subject to on-the-spot checks; public procurement rules; the application of State aid rules; how to calculate flat rate costs; and revenue-generating projects. Managers perceive the Commission's approach to clarifying outstanding issues as inadequate in terms of the timeliness of the advice or clarifications provided. Often, guidelines or specific explanations are seen to be provided when the systems have already been set up or when a problem occurs. For instance, the Welsh authorities had already finalised their proposal for the reorganisation of the Certifying Authority when the Commission issued its guidance note on this subject. There are also concerns over the legal status of the guidance provided. For example, it is not always clear whether guidance is legally binding or simply advice for Managing Authorities. Notwithstanding these criticisms, the actual cooperation between the programme managers interviewed and Commission staff is reportedly to have been good or to have improved compared to the past, not least for the new Member States, thanks to the increased number of domestic staff now working for the Commission.

As discussed in Section 5.1.2, some national coordinating authorities have sought to fill a gap by providing their own guidance to programme Managing Authorities and/or Intermediate Bodies. Managers' views of this approach are mixed. In Finland, regional authorities in the programme of Länsi-Suomi see guidance from the central-level Managing Authority as flawed both because it has sometimes simply repeated the Commission's interpretation of rules and also because this is perceived to have led to guidance overload. In Poland and Italy, however, the central government's role in providing guidance has been considered valuable, not least due to the provision of more detail on the most problematic issues (e.g. cross-financing, indirect costs).

A more general concern relates to the degree to which Commission's expectations are realistic. Programme managers question the awareness of Commission staff of the amount of human and financial resources involved in the tasks of financial management, control and audit. The Commission is perceived to be too distant from grassroots programme delivery and not always able to understand the implications of the demands posed on programme managers, Intermediate Bodies and beneficiaries. The improvement of communication between Commission and domestic authorities, and the strengthening of horizontal exchange fora, such as COCOF, are considered key in this respect. It is also argued that improved communication would also help to identify potential issues at an early stage, limiting some of the more serious problems which are often only discovered during audits.

7.4.4 The need for better coordination at Commission level

A number of programme managers note recent improvements in the level of coordination between Commission DGs. For instance, the Swedish Audit Authority has received comments from the Commission concerning its Audit Strategy, and from the comments received it was clear that there had been some inter-DG consultation. However, coordination between different Commission's DGs – particularly between DG Regional Policy, DG Employment, DG Agriculture and DG Competition - is still not considered to be satisfactory (Austria, Czech Republic, Finland, Greece, Nordrhein-Westfalen, Slovenia, Scotland, Wales). Individual DGs, for instance, often ask Member States to provide information that they could gain from one another, and do not coordinate their audit visit plans, potentially leading to audit overload in certain programmes. The fact that the same programme and beneficiary can be subject to repeated audits is not considered useful and is seen as expensive (Czech Republic, Portugal, País Vasco). Moreover, the lack of coordination between EU auditors can create a degree of uncertainty amongst the audited organisations, especially if an audit visit detects problems in procedures and systems which had previously been approved by other audits. In similar vein, different DGs may have different views on similar issues. For instance, in 2006 major efforts were made to develop a risk assessment system for the Highlands and Islands 2000-06 programme, which was accepted by DG Regional Policy but rejected by DG Employment.

Programme managers expressed further concerns regarding coordination within DG Regional Policy, for example in terms of the lack of common understanding of EU requirements between Country Units and the Audit Directorate.

7.4.5 The need to increase proportionality

Some programme managers argue in favour of greater proportionality, and emphasise the need to have different levels of rules for: (i) different sizes of programme, (ii) different sizes of project; or even (iii) different levels of national Structural Funds' receipts (Austria, Czech Republic, England, Finland, Portugal, Śląskie, Slovenia, Scotland, Wales). Some state that there is a risk that the current approach to financial management, control and audit may alienate more sophisticated, innovative, longer-term types of project (or direct them to domestic funding sources); deter certain types of beneficiary (e.g. small firms or organisations, third sector bodies); or shed a negative light on EU funding or even the EU as a whole.

Various solutions are suggested. Some programme managers argue that it might be preferable to move to a 'net payer' approach, whereby net contributing Member States would pay less into the EU budget and would no longer receive Structural Funds resources but would undertake their own domestic regional policies. Others recommend that Structural Funds procedures should vary more strongly, in line with the level of EU funding or the scale of programmes or projects (Austria, Czech Republic, Finland, Slovenia). Some managers express the view that the 'one-size-fits-all' approach of EU policy does not take into account the specificities of local contexts and constraints. However, whilst most programme managers observe that the administrative costs are often disproportionate, nevertheless there is also awareness that it is difficult to find a correct balance that would ensure sufficiently strict financial control.

7.4.6 The need for real shared management

The programme managers interviewed have a degree of scepticism about the current implementation of the principle of 'shared management' between the Commission and the Member States. In principle, this should entail a separation of roles between EU and national levels but, in practice, managers feel that the EU level is over-stepping the boundaries of its responsibilities, not least by undertaking detailed controls and audits that should be left to Member State authorities. Similarly, the need to gain Commission approval of a detailed description of management and control systems is seen to cancel out the simplification associated with the elimination of the programme complement. There is a feeling among programme managers that, whilst the Commission wishes to engage in a closer partnership with national authorities, at the same time it does not entirely trust them. In this sense, while there is in principle greater freedom for national and regional authorities to design and manage the OPs, this is not seen in practice due to extensive EU financial management, control and audit procedures.

A number of programme managers (e.g. England, Germany, Sweden) argued that greater use should be made of Member States' existing domestic financial control and audit systems and bodies, and that the Commission should focus more strongly on certifying these systems. While they agree that there is a need for effective coordination and cooperation at EU level, detailed aspects of financial implementation, control and audit should be left to the Member States. Programme managers emphasise that Member States already have systems which are implemented by competent, professional, transparent and accountable audit authorities and which comply with international codes and professional standards.

7.4.7 The need to re-consider the appropriateness of the EU approach

More fundamentally, some programme managers question the adequacy of the current approach for detecting and preventing fraud (France, Vlaanderen). There is some unease regarding the fact that, whilst the current financial management, control and audit systems have become increasingly sophisticated, thus far this has not contributed to reducing the rate of irregularities. Programme managers argue that the current approach may not be what is needed to achieve the ultimate aim of the controls. The EU rationale seems to be that, in order to reduce fraud, there is a need to limit the number of formal errors and irregularities – yet some Member States question this approach. They argue that, although there is a need to ensure effective systems for combating fraud and to ensure the proper use of public funds, there is also a need to take account of the costs of financial management, control and audit systems. In particular, some argue that the costs of these systems should not exceed the potential loss incurred due to fraudulent activities or mistakes and should be proportionate to the level of EU funding (Denmark, Slovenia, Vlaanderen).

Box 20: The problematic topic of revenue generating projects

The issue of revenue generating projects emerged as one of the most critical across the programme managers interviewed (Czech Republic, France, Lombardia, País Vasco, Vlaanderen). They found the regulations unclear and more complex than in 2000-06, yet without a clear rationale for the changes introduced. Managing Authorities and Intermediate Bodies have difficulties in assessing the accuracy of calculations made by project applicants. There are concerns that the approach taken by the regulations could create a situation where large infrastructure projects are not funded because the actual costs are likely to be disproportionate to the amount of funding obtainable, given the need to take into account future revenues. There is also concern that the requirements might deter private actors from participating due to uncertainties over actual revenues which may differ from those calculated ex ante.

For the Flemish programme managers, it is not clear why generating revenues is seen as a negative circumstance for a project, since it enhances the long-term sustainability of the project and its potential economic spillovers. There is no incentive for project applicants to apply for funding if a project is not considered viable and thus revenue-generating.

8. CONCLUSIONS AND QUESTIONS

8.1 Distinctive features of financial control & audit rules in 2007-13

Overall, changes in Structural Funds procedures for financial management, control and audit in 2007-13 are relatively limited, compared to the rules which were in place in the 2000-06 period. Nevertheless, all programme managers interviewed emphasise that there has been an increase in the administrative burden associated with programme management and implementation compared to previous periods. Explicit changes in EU rules mainly reflect ongoing efforts to address various criticisms, notably by raising the quality of Structural Funds financial control and audit, and reducing the duplication of audit work by Member State and EU officials. However, the more rigorous approach to financial control and audit at EU level, and the emphasis on Member States' duties and responsibilities, means that authorities at Member State and programme levels are faced with more extensive and more detailed tasks in this field.

Both the General Regulation and the Implementing Regulation in 2007-13 provide a clearer definition of the roles and responsibilities of relevant authorities. They also reflect developments in the relationship between the Member States and the Commission. This relates first and foremost to the devolution of some audit and control tasks to the Member States, especially via the expanded role of the Audit Authority and the stronger emphasis on domestic systems of checks and balances, as well as the transfer of responsibility for defining the eligibility of expenditure to domestic authorities. At the same time, the Commission has more scope to insist on changes in management, control and audit systems because interim payments in 2007-13 are conditional on Commission approval of the compliance assessment and Audit strategy. Although efforts have been made to increase the proportionality of procedures by eliminating the obligation on smaller programmes to provide an Audit Strategy, this has only limited applicability.

The Commission has launched several initiatives to improve its own activities in the field of financial management and control in 2007-13, most notably the 2006 'Action plan towards an integrated internal control framework', which was complemented by the 2008 'Action plan to strengthen the Commission's supervisory role under shared management of structural actions'. In this framework, the Commission has adopted a more stringent approach, involving greater strategic planning and increased staff levels. Despite remaining differences, coordination between DG Employment and DG Regional Policy is also seen to have improved, based on a shared audit strategy, improved information exchange and efforts to build an integrated internal control framework.

The transfer of greater responsibilities in the field of financial management, control and audit to the Member States is accompanied by increased pressure on Member States to ensure that systems and procedures are fully in line with the regulations. Linked to this, Member States are expected to engage in more extensive reporting to the EU level: in addition to annual programme-level implementation reports and audit reports, Member States must provide annual, national summaries of audits and declarations in relation to financial management and control. EU authorities are also calling on Member States to provide annual Statements of Assurance in relation to their use of all EU funds. Lastly, the introduction of 'Contracts of Confidence' at the end of the 2000-06 period, which provide a means of reducing the duplication of audit work by EU and Member State authorities, and act as a guarantee of the quality of domestic authorities' audit work.

8.2 The effects of financial rules in 2007-13

Programme managers argue that the approach to financial management, control and audit in 2007-13 is affecting administrative approaches, project selection, and broader perceptions of Cohesion policy. However, the range and intensity of concerns varies across partners, and further research would be needed to examine the extent to which these concerns are typical of all or many Structural Funds programmes.

In some programmes, Structural Funds rules are seen to bring some benefits, by enhancing the quality of financial management and control, and by ensuring that all Managing Authorities, Intermediate Bodies and final beneficiaries are subject to equally high standards. Some programme managers also argue, for example, that the description of the management and control system has various positive systemic and procedural effects, not least by reinforcing institutional memory. The stronger emphasis on financial management and control is also seen, in some cases, to be leading to positive changes in culture and mentality among those involved in programme and project implementation.

However, the heavy administrative burden associated with Structural Funds programmes in 2007-13 is also seen to have some negative effects. First, a number of programme managers argued that the strong emphasis on financial management, control and audit (not least the compliance assessment of the description of the management and control system) has reduced the time and resources available to programme managers to ensure project quality and programme impact.

Second, there are concerns that the complexity of Structural Funds rules and the emphasis on on-the-spot checks and audits may deter some types of project applicant to seek alternative, domestic sources of funding. This is not only seen to affect smaller firms and organisations but also some well-established, larger entities with good track records of using Structural Funds resources.

Third, the complexity of financial management and control systems may lead Managing Authorities and Intermediate Bodies to be biased towards projects seen as 'safe', rather than to consider the quality of a project or the extent to which it contributes to programme aims. This may mean that projects perceived as riskier – for example due to their size or novelty – may be financed solely by domestic funding or not at all.

Lastly and more fundamentally, some programme managers note that the increased administrative burden is leading to greater scepticism of the usefulness of EU Cohesion policy as a whole, and could shift Member States' opinion towards a 'net payer' approach, leading Cohesion policy in future to be focused primarily on net recipient Member States.

8.3 Ongoing challenges

Despite the extensive investments in raising the quality of systems and procedures in the field of financial management, control and audit at both EU-level and in the Member States, both the European Court of Auditors and European Commission auditors continue to find high levels of irregularities in Structural Funds programmes. One possible response to this situation is that further efforts are needed by all parties to invest in staff and to improve the approach of different authorities to financial implementation and control.

However, as this paper's description of the views of a range of programme managers has shown, the current approach to financial management, control and audit in Structural Funds programmes has led to a heavy administrative burden, which is often seen as unnecessary, as disproportionate to the level of EU resources, or as duplicating domestic systems. This suggests that more radical change may be needed, for example by decentralising more tasks to the Member States or by enhancing proportionality.

8.3.1 How can unnecessary complexities be reduced?

Whilst there is acknowledgement amongst programme managers that the Structural Funds approach to financial management, control and audit has led to a more methodical and systematic handling of all procedures connected to programme implementation, all partners have called for a move towards genuine simplification and proportionality. Past simplification attempts are seen to have failed to deliver the desired effects, and further efforts are now argued to be needed to design more time-efficient and cost-effective procedures.

However, the goal is not easy to achieve, not least due to pressure from the European Parliament and Court of Auditors on the Commission to ensure that its systems and procedures reduce the level of financial irregularities. Further discussion will therefore be needed to find ways of reducing complexity, while still ensuring that financial management, control and audit systems pick up irregularities and fraud.

There is widespread recognition that Cohesion policy (like other aspects of EU budgetary policy) is characterised by high inherent levels of risk due, for example, to the multiple actors involved in implementation, the dependence on beneficiaries for declaring payments, and the complex nature of projects funded. One possible means of reducing errors would therefore be to limit the level of complexity in Structural Funds programmes and projects – yet this could fundamentally change the character of these programmes, if it led to a narrower definition of project applicants or programme partners.

A further possibility would be to introduce a stronger focus on the detection of fraud (rather than all financial irregularities) and to concentrate more strongly on the major sources of risk. This would imply that smaller projects and programmes would be subject to a lighter touch in terms of financial control and audit.

8.3.2 How should tasks be shared between the Commission and the Member States?

A number of the programme managers interviewed observe that the shift towards decentralisation and shared management, which was discussed in the run-up to the 2007-13 period, has not materialised in practice. Instead, processes are highly formalised processes and the Commission continues to undertake in depth checks on programme management and implementation. Many programme managers argue that detailed policy implementation should be left to Member States authorities, and that the Commission should focus on oversight and strategic orientation. Such an approach would also reduce problems related to the lack of harmonisation between EU and domestic frameworks.

However, such a fundamental change would be difficult to achieve given that the Treaty allocates ultimate responsibility for the implementation of the EU budget to the Commission, even in fields of shared management such as Cohesion policy. Even within the bounds of the Treaty and the Financial Regulation, it is hard to see how further decentralisation could be introduced in the face of the ongoing pressure from the Parliament and Court of Auditors for further improvements in financial control and audit.

As noted in Section 2, the difficult relationship between the Commission and the Member States in relation to financial management and control are typical of the 'principal-agent' problem, which is seen when a central authority has to rely on distant agents to undertake tasks on its behalf.[55] The literature suggests two methods by which the principal can achieve its aims, either by reducing information asymmetries via financial monitoring, control and audit, or by aligning more closely its interests with those of the agent. Perhaps more effort should be focused on the second of these alternatives in the context of Cohesion policy implementation.

8.3.3 Questions for discussion

This paper's overview of the opinions of EU authorities and Member State authorities has illustrated the extent to which there are widely differing views as to the types and degree of change needed in the field of Structural Funds financial management, control and audit. It is therefore clear that further discussions are needed on these issues among all actors involved in Structural Funds programmes. Some key questions include:

What is the experience of programme managers in gaining Commission approval of the compliance assessments and audit strategies for 2007-13? Have partners already obtained Commission approval?

Do stronger rules on financial management, control and audit mean that Structural Funds resources are seen as less relevant or desirable for some types of project or project applicant?

[55] J. Stiglitz (1987) *op. cit.*

Do rules on financial management, control and audit mean that there is less time to consider the content or effects of projects or programmes?

Do programme managers have additional mechanisms which aim specifically to detect fraud (rather than broader financial irregularities)?

Should the proportionality principle be applied at project level as well as at programme level i.e. should there be lighter rules for smaller projects? What is the definition of a 'smaller' project?

Should there be a shift to focusing primarily on major risk areas (e.g. larger or more difficult projects)?

Should there be a stronger focus on detecting fraud rather than on eliminating formal or administrative irregularities? Is there a grey area between fraud and formal irregularities (e.g. in relation to the eligibility of expenditure)?

Should more use be made of Member States' financial control and audit authorities? How could EU authorities be sure of the quality of the work of these authorities?