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EC Guidance

Management verifications and audit

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Financial instruments 2014-2020

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Outline

- **Legal framework 2014-2020**
- **New approach, main changes for MAs, CAs and AAs**
- **Main shortcomings / audit findings of period 2017-2013**
- **Update of audit methodology**
- **Conclusions**

Legal framework

CPR No. 1303/2013

Part II (for ESI Funds)

- Art 40 Management and control of financial instruments
- Title VIII- Management and control systems
- Title IX- Financial Management, Examination and Acceptance of accounts and financial corrections

Legal framework

Part IV (for ERDF/CF/ESF/ EMFF)

- Title I - Management and control

Articles 122-127

- Title II - Financial Management, Preparations, Examination, Acceptance of accounts and financial corrections

Articles 128-148

Legal framework

CDR No. 480/2014

- Chapter II-Section II- Financial instruments
 - Art 7-Criteria for the selection of bodies implementing financial instruments
 - Art 9-Management and control of financial instruments set up at national, regional transnational or cross-border level
- Chapter IV-Section II: The audit trail and use of the data collected during audits
- Chapter IV-Section III: Audit of operations/accounts

Legal framework

CIR 821/2014

Art.10- Documentation of the system

Annex I - Model for reporting on financial instruments

Guidance Notes on financial instruments

Please visit

<https://www.fi-compass.eu/resources/ec>

Guidance on Management and Control

Final versions:

The final versions of the guidance notes on management and control are available in

WIKI:

<https://webgate.ec.europa.eu/regiokm/dashboard.action>

Inforegio:

http://ec.europa.eu/regional_policy/en/information/legislation/guidance/)

and

CIRCABC:

<https://circabc.europa.eu/>

(look under EGESIF/final documents)

Assurance model for instruments implemented by EIB / other international FIs

- *EP and ECA asked EC to undertake measures to overcome the "accountability gap" for FIs implemented by EIB due to restrictions for MS to carry out their controls/audits*
- *For closure 2007-2013, specific Agreed Upon Procedures (AUP) with an audit methodology agreed EIB-EC. Results were provided to MS in due time for their assurance*
- *For 2014-2020, AUPs are already in place for SMEi. Revised model to be developed in Omnibus*

Managing Authority

New requirements

- Effective and **proportionate anti-fraud measures**
- Drawing up a **management declaration** on the functioning of the systems, legality and regularity of transactions and sound financial management (Art.59(5)(b)FR)
- Drawing up an **annual summary** of final audit reports and verifications and controls carried out, analysis of nature of errors and **corrective actions taken or to be taken**
- **Report to EC by 15th February each year**

Management verifications for financial instruments

Guidance Note EGESIF 14-0012 02 (section 2.4)

- It should be ensured that the set-up of the financial instrument as well as its implementation are in accordance with applicable law, including rules covering the ESI Funds, State aid, public procurement and relevant standards and applicable legislation on the prevention of money laundering, the fight against terrorism and tax fraud
- Management verifications of financial instruments are quite specific and require adequate knowledge in this respect

Management verifications for financial instruments

Managing authority shall carry out

- administrative verifications on each application for payment submitted by the beneficiary

- on-the-spot verifications of operations
 - The frequency and coverage of the on-the-spot verifications shall be proportionate to the amount of public support to an operation and to the level of risk identified

Certifying authority

- Submitting interim payment applications certifying that these are based on reliable accounting systems, verifiable supporting documents and subject of management verifications. Each payment application should include Appendix 1 with specific information on financial instruments
- Drawing up the accounts (New). Certifying the completeness, accuracy and veracity of the accounts and compliance of expenditure with applicable EU and national rules. The accounts should include Appendix 6 with specific information on financial instruments

Audit Authority

- Provide an **audit strategy**
 - Carry out audits on **systems**
 - Carry out audits on **operations** - Select sample in reference to the accounting year (July n-1 to June n+1)
 - Carry out audits of the **accounts** (new)
- **Report to EC by 15th February each year, providing an annual control report and audit opinion**

Main EC audit findings 2007-2013

Set-up of the instruments

- National co-financing not effectively paid
- Non-compliance with the rules for selection of Financial Intermediaries
- Missing of compulsory elements in the funding agreement
- Investment strategy inconsistent with programme's objectives
- Returns from investment not to be entirely re-used
- Conversion of ERDF contribution into a debt-to-equity
- Lack of audit trail, e.g. absence of use of adequate accounting codes

Main EC audit findings 2007-2013

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Main EC audit findings 2007-2013

Implementation

- Absence or inadequate management verifications
- Lack of control on the SME status
- Investments not implemented in eligible region
- Financing firms in difficulty
- Financing provided to ineligible final recipients or for ineligible activities
- Risk of management costs exceeding maximum thresholds set in the Implementing Regulation
- Wrong calculation of the eligible expenditure for guarantees

Main EC audit findings 2007-2013

Implementation

- State aid
- Ineligible management costs
- Irregular preferential treatment of Financial Intermediaries
- Combination of different forms of assistance (FEI loans, FEI guarantees and grants) without respecting EU and national law and contractual arrangements
- Incorrect use of returns from loans and resources returned from loans provided
- Final recipients charged with unjustified costs
- Modification of the typology of investments and proof of investments not adequately assessed against the initial objective of the loan

Audit Manual

- Update of the current audit framework 2007-2013
- Provide guidance and a practical tool for the management verifications and audit of financial instruments
- Cover key audit areas relevant to FI at different levels
- Endeavour a common coherent approach;
- Focus on main risky areas

Phases of the audit

- Phase 1: Preliminary study and planning
- Phase 2: Audit of the set-up of the FI
- Phase 3: Audit of the implementation of the FI

Phase 1- Preliminary study and planning



Audit objectives and scope

- compliance with applicable regulations
- consistency with guidelines and interpretations
- proper and effective management and control systems over FI operations
- expenditure declared is legal and regular in all material respects

Consideration of risks

- COMPLIANCE with EC Regulations and guidance
- COMPATIBILITY with OP objectives, investment strategy and funding agreements
- INHERENT to the operations (structure, financial products and final recipients)
- MANAGEMENT AND CONTROL SYSTEMS

Phase 2- Audit of the set-up

- Structure, main actors and responsibilities
Any issues identified?
- Ex-ante assessment carried out?
- Contributions (OPs, ERDF, Additional resources (beyond OP contributions, amounts/value, source, timing, type and terms & conditions)
Consistent with OP? Materialised as foreseen?
- Selection of Fund manager
- Overall business plan

Phase 2- Audit of the set-up

- **Funding agreement (very important for control purposes, to be checked in detail)**
 - Does it cover elements of Annex IV of CPR?
- Establishment of management costs and fees
- State aid elements are considered?

Phase 3- Implementation

- Based on a sample of investments / final recipients
- Audit to be carried out at the level of financial intermediaries unless conditions of Article 40.3 are fulfilled
- Testing of regulatory aspects related to the financial product
 - Monitoring activity (by the IFI and/or with the MA's representatives)
 - Irregularities identified by the IFI
 - Composition and main decisions of the Investment Board
 - Compliance with State aid rules
 - Main amendments in the funding agreement
 - Pipeline overview
 - IFIs Publicity activities

Conclusions

- Management verifications are the main pillar of the assurance. Managing authority to annually sign the management declaration
- FIs to be checked at several stages throughout the programming period based on progress of implementation (to timely identify issues and be preventive)
- Audits by audit authorities to confirm the well-functioning of the management and control systems in place for FIs

Conclusions

- Assurance to be given on an annual basis
- Commission relies more on audit work of Member States, improved coordination to achieve an integrated control framework
- EC audit work focused on the review of work of AAs. Thematic audits on financial instruments are foreseen in the Single Audit Strategy (probably starting in 2018)
- Audit manual to be provided in 2018 to all Member States authorities to help them performing their control/audit obligations