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EMPLOYMENT, SOCIAL AFFAIRS AND INCLUSION
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Joint Audit Directorate for Cohesion

Risk based management verifications
Article 74(2) CPR 2021-2027[1]

REFLECTION PAPER

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May 2023

[1] **DISCLAIMER**. This reflection paper expresses the views of the Commission services and does not commit the European Commission. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law.

Abbreviations

AA	Audit Authority
AMIF	Asylum, Migration and Integration Fund
BMVI	Border Management and Visa Instrument
CPR	Common Provisions Regulation
EC	European Commission
ECA	European Court of Auditors
EMFAF	European Maritime, Fisheries and Aquaculture Fund
ERDF	European Regional Development Fund
ESF+	European Social Fund+
FI	Financial Instruments
FNLC	financing not linked to costs
IB	Intermediate Body
ISF	Internal Security Fund
KR	Key Requirement
MA	Managing Authority
MCS	Management and Control system
SCO	Simplified Cost Options
TER/RER	Total Error Rate / Residual Error Rate

1 Legal Basis

Recital 62

To ensure an appropriate balance between the effective and efficient implementation of the Funds and the related administrative costs and burdens, the frequency, scope and coverage of management verifications should be based on a risk assessment that takes into account factors such as the number, type, size and content of operations implemented, the beneficiaries as well as the level of the risk identified by previous management verifications and audits. Management verifications should be proportionate to the risks resulting from that risk assessment and audits should be proportionate to the level of risk to the budget of the Union.

Management Verifications (Article 74(1) Common Provisions Regulation 'CPR')[2]

Programme management by the managing authority

1. The managing authority shall:

(a) *carry out management verifications to verify that the co-financed products and services have been delivered, that the operation complies with applicable law, the programme and the conditions for support of the operation, and:*

[…]

Management Verifications (Article 74(2) CPR)

Management verifications referred to in point (a) of the first subparagraph of paragraph 1 shall be risk-based and proportionate to the risks identified ex-ante and in writing.

Management verifications shall include administrative verifications in respect of payment claims made by beneficiaries and on-the-spot verifications of operations. Those verifications shall be carried out before submission of the accounts in accordance with Article 98.

[2] Interreg Programmes may decide that management verifications are not carried by the MA (Article 46(3) of Regulation (EU) 1059/2021 (Interreg Regulation)): "*By way of derogation to point (a) of Article 74(1) of Regulation (EU) 2021/1060 and without prejudice to Article 45(5) of this Regulation, the Member States, and where applicable, the third country, partner country or OCT, participating in the Interreg programme, may decide that management verifications referred to in point (a) of Article 74(1) of Regulation (EU) 2021/1060 are to be done through the identification by each Member State of a body or person responsible for this verification on its territory (the 'controller')."*

2 General principles – new elements

The new approach of risk-based management verifications is key to strike a balance between the protection of the EU budget and the most required simplification in the 2021-2027 programming period.

This approach will:

- significantly reduce the administrative burden for beneficiaries (as the number of controls will be reduced) as well as for MAs and their IBs;
- improve the effectiveness of management and control systems by allowing to focus management verifications on problematic areas instead of spending time and resources on verifications of every single euro declared.

The present document is designed for EC staff (both desk officers and auditors), to be used in carrying out their tasks. It may as well be used by MAs and AAs in their activities. It aims to offer a better understanding of the new approach in risk-based management verifications by providing examples and best practices. The document does not provide support tools (e.g. formats for a risk assessment strategy, templates, risk assessment grids etc.). MAs remain responsible for developing and implementing the risk-based management verifications.

MAs and IBs carry out risk-based management verifications[3] in accordance with Articles 74 (1)(a) and (2) CPR, to verify the delivery of the co-financed products and services, the reality of expenditure claimed for reimbursement, the compliance with the terms of the relevant Commission Decision approving the programme and applicable Union and national law, as well as the conditions for support of the operations.

The risks and examples (in Annex 1 – Examples) in this paper are for reflection and illustrative purposes and should always be considered in the context of a specific programme and the related management and control system.

Management verifications include **administrative verifications** in respect of payment claims by beneficiaries and **on-the-spot verifications** of operations.

<u>In accordance with Article 74(2) CPR, the new elements (in comparison to the 2014-2020 CPR legal framework) are:</u>

[3] Article 46(3) of the Interreg Regulation sets out that management verifications in Interreg programmes, by way of derogation, can be carried out by controllers appointed by each Member State (MS). Under Article 74 (paragraph 2) CPR risk assessment are to be carried out by the MA. In Interreg, when the Article 46(3) Interreg derogation to point (a) of paragraph 1 of Article 74 CPR is used, controllers (or the MS) may prepare the initial risk assessments, but in this case it is recommended that the risk assessments are reviewed by MA in order to ensure equal treatment and considering the cooperation goal of these programmes. Any difference in approach between MS should be duly justified.

→ Both administrative and on-the spot management verifications **are risk-based** and proportionate to the identified risks,

→ The MA prepares **ex-ante and in writing a risk assessment**, which should also address how **proportionality** will be put into practice (e.g., criteria for having verifications that are proportionate to the types and levels of risks),

→ Management verifications (administrative and on the spot) are to be **carried out before submission of the accounts**.

Consequently, for both administrative and on the spot verifications:

- The ex-ante risk assessment prepared by the MA/its IBs should define the risk factors/criteria (e.g., number, type, size and content of the operation, type of beneficiary, experience, complexity of the operation, results of past audits/verifications, value of items, etc.) for the selection of operations and payment claims that may be subject to verifications. The MA may also define a certain coverage to be reached by management verifications;
- The rationale of performing an ex-ante risk assessment is to ensure an appropriate balance between the effective and efficient implementation of the Funds and the related administrative costs and burdens. This means that not all payment claims from beneficiaries and not all operations have to be subject to management verifications;
- While a 100% verification of the expenditure remains theoretically possible, this can only be carried out in cases when the level of risk to the budget of the Union was so severe that it would impose such an approach;
- Within a payment claim or operation selected for verification, not all expenditure items and supporting documents (invoices, related contracts, etc.) need to be verified. MAs/IBs can focus verifications on areas where, according to their assessment, the risk of error is higher;
- The risk assessment (to identify the operations, payment claims and expenditure items to be verified) is established ex-ante and in writing by the MA/IBs.

The risk assessment involves two steps:

- The first step is establishing (or updating) the risk assessment. This involves the identification, definition and analysis of the risk factors (see further below). The assessment should be regularly reviewed. In particular, the revision should take into account the results of administrative and on-the-spot verifications performed, findings arising from work of other control/audit bodies (AA, Commission auditors and the European Court of Auditors-ECA) as well as horizontal implications of suspected fraud cases for the management and control systems and external factors which could have an impact on the implementation of operations (e.g., potential conflicts of interest and issues reported in media). In this regard an annual reflection, for example after the results of the audit work become available for the Programme authorities, is expected, which, if necessary, should further on trigger a revision of the risk assessment (please also refer to Chapter 8 of the present paper);

- The second step is the application of the risks identified to the operations generating expenditure or payment claims and further on carrying out the required management verifications.

The MA is responsible for organising its capacities and resources (as well as those of its IBs) to ensure that management verifications (both administrative and on-the-spot) cover the risks identified and are timely carried out at the latest before submission of the accounts.

Good communication between the MA and AA is important. As a good practice, the MA should inform the AA about their risk assessment in order to have a mutual understanding and enhance the quality of the MA's risk-based approach. The AA can provide comments about the MA's risk assessment and methodology but it is up to the MA whether to take these into account.

The risk assessment should improve the MA's/IB's understanding of relevant aspects and risks and this in turn enhances the quality and effectiveness of management verifications. For these reasons the full outsourcing of the risk assessment is not recommended. The responsibility for the risk assessment methodology remains with the MA.

Taking into account the proportionality of the coverage and frequency of management verifications, as well as Article 80(1) first subparagraph second sentence of the CPR, a multiplication of controls at beneficiary level should be avoided unless needed in line with the risk assessment of the MA.

Training and capacity building

MAs may refer to AAs for advice and support with regard to the development, organisation, and delivery of training on risk assessment and verification techniques.

Peer-to-peer training delivered by MAs of other Member States and information sessions (for example by Commission services) may also be useful to build capacity.

3 Risk assessment timing and elements

MAs need to carry out the risk assessment ex-ante, before they start to carry out management verification. The risk assessment is carried out globally, for the totality of operations, payment claims and beneficiaries, but by taking in due account the risk elements. The risk assessment could be carried out already at the very beginning of the programme (by considering the experience in 2014-2020 or, for example, the type of operations/beneficiaries/categories of expenditure expected).

Alternatively, the MA may decide to wait for the selection and appraisal of operations as at this moment in time they collect important information about the risks related to the operations and beneficiaries which can be used in the risk assessment for management verifications. At selection stage, cconditions related to the operational, technical, financial and administrative capacity of the applicants and the type of operations to be implemented become available and therefore they may be taken into account for the risk assessment related to management verifications (e.g. the complexity of the operation which can be established at the moment of selection). In practice the MA usually considers and assesses (levels of) risks, already at the stage of selection of operations, and this is often recorded in checklists/project evaluation forms. MAs are recommended to document this work (in the electronic system) so the results can be taken into account when the risk assessment for management verifications is performed. In this manner, when the MA is developing the risk assessment for management verifications it can build on this pre-existing work.

The MA/IB may consider the following potential risk elements at operation and beneficiary level during the risk assessment (non-exhaustive list):

At the level of operations

- ✓ Operations with a significant budget
- ✓ Nature and complexity of the operation, type(s) of expenditure, legal requirements applicable (e.g., public procurement, State aid, Financial Instruments (‘FIs’)[4], etc.). **Example 1.1 – Complex operations.**
- ✓ Operations which had already started before selection, or which are close to completion when being selected
- ✓ Operations with few tangible outputs for which, because of their nature, little or insufficient evidence is expected to be available after they have been completed. **Example 1.3 – Tangible and intangible outputs**
- ✓ On-the-spot (‘OTS’) visit not possible or delayed (e.g., COVID pandemic, delays in implementation, other reasons)[5]
- ✓ Operations approved and started near the end of the programming period
- ✓ Operations implemented in different locations[6].
- ✓ Operations formed by multiple projects (all sub projects selected by the MA/IB and forming part of an operation) or operations where there is a cascade of support).

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[4] For example: FIs’ expenditure does not, in general, necessarily involve higher risks. However, in some cases they tend to have complex set-up and various actors and organisations involved in the implementation, in which case the risk increases significantly.
[5] Applicable for the review of the risk assessment.
[6] Such cases are essentially normal in Interreg; however if, for example, a beneficiary implements the operation in 5 different locations in a region, then this can still be considered as a potential risk.

- ✓ Phased operations from 2014-2020
- ✓ Duration of the operation (multi-annual)
- ✓ Number and types of different cost categories
- ✓ Number of modifications of the operations (changes compared to the initial grant agreement)
- ✓ Operations receiving financing from different sources
- ✓ Operations which use for a first-time new approaches (e.g. FNLC, a new type of SCO for the respective programme). **Example 1.2 – Simplified Cost Options ('SCOs')**
- ✓ Operations with a risk of double financing
- ✓ Operations with risks related to limited access to documents, e.g. classified documents (specific in case of HOME operations).

At the level of beneficiaries

- ✓ (Lack of) experience of the beneficiary in implementing (similar) EU funded projects
- ✓ Type, legal status and ownership structure of the beneficiary
- ✓ Level of risk of potential conflicts of interest related to a certain type of beneficiary and the type of operation the beneficiary is implementing
- ✓ Number of operations implemented by the same beneficiary. **Example 1.4 – Number of operations implemented by a beneficiary**
- ✓ Number of partners in the operation[7]. **Example 1.5 – Multi-partner projects**
- ✓ Beneficiary's capacity to implement the operation
- ✓ Change of beneficiary during implementation
- ✓ Involvement of International organization on project implementation (specific approach for HOME funds)

For the purpose of identifying risks at beneficiary level the MA may refer to IT tools such as national electronic data exchange systems (Article 69(8) and Annex XIV CPR), data-mining/risk scoring tools (e.g., Arachne) as these may provide useful information on risks of fraud, of possible irregularities, of concentration of funding or of possible double-funding. In this context, such data-mining/risk scoring tools primarily serve as a risk assessment support tool.

To ensure that management verifications are timely carried out (**before submission of the accounts** in which the expenditure is declared), the MA[8] is encouraged to draw up an indicative

[7] Such cases are essentially normal in Interreg; however, if, for example, a cross border project is implemented by a high number of partners, this can be considered as a potential risk.

"Management verifications Plan *(for both administrative and on-the-spot verifications)*" for each accounting year. When establishing the plan, the MA can take into account:

- The risks identified during the risk assessment;
- The estimated timing of the submission of the payment claims based on the (indicative) timetables for the implementation of the operation phases and the related financial forecasts in the approved operation applications/grant agreements;
- The envisaged timeframe (number of days) by which administrative verifications should be performed (considering also the deadlines set for payments to beneficiaries)
- The planning of the respective operation (e.g. in order to perform an on-the-spot visit, if required, in relevant moments of the project life cycle).

The administrative verifications and on-the-spot verifications may have different schedules and frequency.

The management verifications plan may be reviewed in line with the changes encountered during implementation.

4 Administrative verifications of beneficiaries' payment claims

The administrative verifications of beneficiaries' payment claims are performed taking into account the financial progress of operations.

It is advisable that administrative verifications are carried out within a reasonable time frame after a payment claim is submitted by the beneficiary, before the expenditures are included in payment applications to the Commission. In line with Article 91(1)/CPR, every year, one payment application may be submitted at any time in each time period between the following dates: 28 February, 31 May, 31 July, 31 October, 30 November and 31 December[9].

Moreover, early detection of errors by the MA is important, as detection before inclusion in an application for payment to the Commission reduces the frequency and impact of irregularities in the accounts. Consequently, early management verifications (before the MA submits the expenditure to the Commission) are strongly encouraged.

In this respect it is important to stress that, as for the treatment/impact of detected irregularities, the MA's risk-based management verifications differ fundamentally from the AA's audits of operations. Irregularities found by the AA during the audit work are projected to the total population of beneficiaries and payment claims (in order to establish the error rate for the accounting year), since the AA's work is normally based on a statistical sample[10]. It is not

[8] In the case of Interreg Programmes, the controllers (or the MS) may draw up the verifications plans but it is recommended that the MA reviews them.
[9] Not applicable for Interreg Programmes
[10] Even in case conditions for the use of a non statistical sample are fulfilled, results are still projected to the entire population.

foreseen for MA/IBs to perform statistical sampling for management verifications. Hence, errors discovered by the MA/IBs during their management verifications are not projected to the population. However, the MA/IBs should not only correct individual errors that are identified by management verifications, they should also assess any systemic impact of the errors they detect, at the level(s) of operations/beneficiaries, measure or programme, and address such issues (e.g. by extending the level of verifications in those specific areas / expenditure / beneficiaries and also by revising the risk assessment).

The MA/IBs may therefore reduce risks upstream and prevent irregularities from occurring. MAs/IBs may also consider further capacity building at the level of beneficiaries e.g., by providing targeted training and information sessions, in particular by drawing the lessons from past errors or difficulties encountered by similar beneficiaries.

4.1 Selection of payment claims for administrative verifications

The selection of payment claims and supporting documents will be performed on the basis of the risk criteria and elements established ex ante by the MA/IBs.

The following types of payment claims could be considered in order to avoid irregularities being identified in a subsequent payment claim which would also affect previous payment claims:

- ✓ First payment claim of the beneficiary, so that the MA can assess any risks associated with the specific operation and/or beneficiary and take them into account for further verifications and a related review of the risk assessment,
- ✓ First payment claim(s) with expenditure including types of costs identified as risky,
- ✓ First payment claim(s) containing expenditure for procurement contracts,
- ✓ Payment claims for operations for which risks were identified during the selection stage[11].
- ✓ Payments claims including for the first time expenditure from phased operations.

The results from any previous verifications and audits should be taken into account.

4.2 Selection of items to be verified inside payment claims selected for administrative verification

The MA/IB is recommended to review the expenditure submitted by the beneficiary (with details of all items claimed) to obtain an understanding of the type and nature of the expenditure (categories) claimed.

For cases where the MA decides not to verify fully the selected payment claim(s), the selection of expenditure types in the payment claim (e.g., staff costs, procured items, etc.) is to be

[11] Provided the risk assessment is carried after the selection stage.

performed on the basis of the risk assessment of the MA/IB. Expenditure types that, in the opinion of the MA/IB, have a higher risk, are unusual or give rise to suspicion of fraud or exceed a certain amount or percentage of the total costs declared in payment claim, could be considered for verification. The criteria for this risk assessment should be clearly set out in the MA's ex-ante risk assessment.

The selection of items for verification can be done for budget lines / types of expenditure in the payment claim. The MA may decide to establish a minimum number of items to be verified or a minimum percentage of the expenditure included in the payment claim.

Example 1.6 – Minimum coverage

In case a high number of expenditure items with the same level of risk are present within a budget line/type of expenditure selected for verification, the MA may verify only some of these items. The MA's risk assessment and relevant management verification procedures should specify how these items will be selected and the approach to be taken when irregularities are identified in verified items. For example, the verification may be extended to other items, if necessary, for example if a high number of errors is identified, up to a full verification of all such expenditure.

This paper does not provide a sampling methodology. Sampling and rules for extension of samples (depending on the results of verifications carried out), if applied, should be addressed in the MA's risk assessment paper.

A risk-based approach can also be applied for the verification of public procurements (in case this is done with the administrative verification of payment claims). Such a verification does not necessarily need to cover all public procurement procedures in an operation and the MA/IB may select only some of procurement expenditure items for verification. When assessing the risks, it is recommended to consider the value of the contracts (e.g. with regards to the thresholds for the application of the public procurement Directive) and to consider, in particular, the expertise of the contracting authority and the existence of past irregularities detected by EU or national bodies for the same contracting authority.

The MA/IBs may discuss with the AA on the above mentioned.

4.3 Coverage of administrative verification

While a 100% verification of a population of payment claims and of the expenditure within payment claims remains theoretically possible, this can only be carried out in cases when the level of risk to the budget of the Union was so severe that it would impose such an approach.

The purpose of risk-based management verifications is to rationalise these verifications and to have an appropriate balance between the effective and efficient implementation of funds and related administrative costs and burdens (as per Recital 62 of the CPR).

For the MA, bearing responsibility for the programme, the objective is to be able to draw a conclusion from the management verifications performed when these do not cover all expenditures (to be) declared to the Commission. The MA must be in a position to confirm that the expenditure included in the accounts submitted to the EC is legal and regular, including the part of the expenditure that the MA have not effectively verified.

This is possible if the risk assessment is adequately designed and carried out. The MAs should be able to achieve a better quality of management verifications by focusing the necessary resources on key areas.

The MA can confirm that the expenditure is legal and regular if it considers that the risk-based verifications performed sufficiently cover the risks. Depending on the verification results, the MA may conclude that risks are sufficiently covered or that verification work should be extended in a certain area / for certain types of expenditure or beneficiaries. This is essentially a matter of judgment. At a later stage, the TER established by the AA (based in principle on a statistical basis) will confirm or put into question the MA's conclusion. In case the AA concludes that the level of error in the population remained material, the MA/IBs should subsequently adapt their risk assessment methodology and verification approach.

5 On-the-spot management verifications of operations

On-the-spot management verifications cover in particular[12] the risks related to the delivery of the product, work or service in compliance with the terms and conditions of the grant agreement, physical progress, and respect of the EU rules on publicity[13]. An on-the-spot management verification also includes checking whether the beneficiary provides accurate information on the physical and financial implementation of the operation (including output and/or result indicators). Consequently, on-the-spot verifications should preferably be undertaken when the operation is well under way, both in terms of physical and financial progress.

On-the-spot verifications for <u>financial instruments</u> are performed on a sample (of financial instruments) proportionate to the risks and are carried out at the level of the Holding Fund (except for the EIB group), or Specific Fund in the absence of the Holding Fund. Checks at the level of the bodies implementing a Specific Fund with a Holding Fund set-up could be performed and adjusted in time depending on the risks identified (historical issues, results of audits, functioning of the Holding Fund and Specific Fund). The MA/IBs could also participate in the on-the-spot verifications if these are carried out by the Holding Fund. In the context of guarantees, the MA/IBs carry out on-the-spot verifications at the level of the bodies delivering the underlying new loans. The MA may decide to rely on on-the-spot verifications carried out by

[12] The list is indicative, on-the-spot verifications can cover a variety of issues.
[13] In case of a breach of EU rules on publicity (Article 50(3) CPR, this could lead to the cancellation of up to 3% of the support from the Funds by the MA.

external bodies, provided the necessary assurance on the competence and quality of the work of these external bodies is obtained.

5.1 Selection of operations to be verified on-the-spot

The population subject to possible on-the-spot management verifications includes all operations for which expenditure is expected to be included in the accounts of the accounting year concerned (i.e. expenditure entered or to be entered in payment applications submitted to the Commission in that accounting year), with a focus on operations which are considered risky.

The MA/IBs can plan on-the-spot verifications as soon as they have information (or at least an estimate) on (a substantial part of) the expenditure (to be) declared by the beneficiaries and to be included in the accounts of the accounting year concerned.

Example 1.10 – Planning of on-the-spot verifications

In some cases, it may be useful and efficient to combine an administrative and an on-the-spot verification and to perform these either simultaneously or back to back.

Depending on the risks taken into account for administrative or on the spot verifications, some operations/payment claims may be subject to an on-the-spot verification without a preceding administrative verification. In such cases the MA/IB may consider to prepare the on-the-spot verification by carrying out an administrative verification (even if not initially planned), thus ensuring to obtain a full background and understanding of the operation in view of the on-the-spot verification and a sufficient mitigation of risks.

The MA/IB may consider the following (risk) elements when selecting the operations for on-the spot management verifications (non-exhaustive list):

- ✓ Operations where previous administrative management verifications or audits have identified progress/reporting problems, irregularities, double-funding or suspicions of fraud[14]
- ✓ Operations that are expected to be completed/implemented within the accounting year and have not been verified on-the-spot before,
- ✓ Operations with advanced levels of implementation (physical/financial),
- ✓ Operations with problems identified by the MA/IB through monitoring[15]. Such problems may relate to previous financial corrections, delays in implementation, suspicions of fraud, complaints etc,

[14] Applicable for the review of the risk assessment.
[15] Applicable for the review of the risk assessment.

5.2 Selection of expenditures within the operation

The MA/IBs can also decide to select and verify only part of an operation. This can be done at different levels. For example:

- ✓ If a group of beneficiaries implements the operation, the MA/IBs may select only part of the operation implemented by some of the project partners.
- ✓ If selected operations contain many payment claims and/or expenditure items/invoices (and considering also the scope of the risk based administrative verifications), the on-the-spot verification may cover only some of these items or aspects (for example, checking physical existence or examining some or all of the public procurements, some physical investments, etc.).
- ✓ If several payment claims have already been subject to administrative verifications, the MA can select only some of them to further verify on-the-spot certain aspects of the expenditure examined in the administrative verifications and its relation with physical outputs. However, it may be efficient to select all the claims for an on-the-spot verification to address issues and doubts raised in previous administrative verifications (issues or doubts which concern all the previous payment claims).
- ✓ If risks are the same for a certain type/category of expenditure, the MA may verify only part of this expenditure (e.g. instead of verifying a long list of staff costs containing bonuses all of which have the same risk profile work contracts, the MA may select a random – not predetermined or preselected- number of items.

6 Electronic systems

The introduction of e-Cohesion[16] aimed to simplify and streamline the implementation of funds governed by the CPR. Electronic data exchange systems allow the secure exchange of born-digital[17] documents or scanned documents from system to system via standardised interfaces between MAs/IBs and AAs on the one hand, and the beneficiaries, on the other hand. An effective implementation and use of e-Cohesion brings about significant benefits:

- ✓ It can significantly reduce the administrative burden both for beneficiaries and programme authorities.

[16]"e-Cohesion" is one of the elements introduced in the 2014- 2020 programming period that aims to simplify and streamline the implementation of the Funds. Member States had to establish an electronic data exchange system which allows the secure exchange of natively digital documents or scanned documents from system to system via standardised interfaces between the Managing, Certifying and Audit Authorities as well as Intermediate Bodies, on the one hand, and the beneficiaries, on the other hand. For EMFAF, AMIF, ISF and BMVI the use of electronic data exchange systems pursuant to Article 69(8) CPR 2021-2027 became mandatory as of 1 January 2023.

[17]Born-digital records are records that have been created in digital format (rather than digitised from paper records).

- ✓ Data will be transferred only once, safely stored in one place and always available for all programme authorities.
- ✓ Electronic submission of information will save time and resources and storage space.
- ✓ It also helps avoiding errors resulting from encoding the same data several times, copying of data, etc.
- ✓ It can enhance controls as IT systems can provide automatic embedded controls and system-generated alerts.
- ✓ Authorised bodies can access information without the need to request (paper) documents.

The use of electronic systems also allows creating and maintaining appropriate electronic audit trails, which comply with relevant requirements on availability of documents (Articles 69(6), 82 and Annex XIII CPR).

Consequently, electronic systems used in the context of management verifications can significantly contribute to reducing the control burden.

7 Audit trail

Management verifications should be performed with appropriate arrangements for documentation retention and the keeping of (electronic) audit trails[18]. The use of electronic systems enhances these arrangements. If these conditions are met, the control burden for beneficiaries can be significantly reduced.

7.1Availability of documents

As a basic rule (Article 69(6) CPR), documents must be kept in line with the requirements of Article 82 of the CPR. Hence, MA/IBs should ensure that all supporting documents relating to expenditure claimed for an operation in electronic and/or paper form are kept at the appropriate level and this for a five-year period from 31 December of the year in which the last payment by the MA to the beneficiary was made.

In practice, beneficiaries systematically upload the documents (in electronic form) to the dedicated IT systems managed by the MAs/IBs (Article 69(8) CPR). The systematic uploading of supporting documents even if not all expenditure will be subject to an administrative verification is strongly recommended as it will facilitate access for any type of future verification or audit. Consequently, the MA, AA and other audit and control bodies can refer to these IT systems first. This practice can significantly reduce the administrative and logistical burden for beneficiaries.

[18] Please see the requirements of Annex XIII of CPR.

7.2 Single arrangements

The single arrangements (Article 80(1) first subparagraph second sentence CPR) remain an important principle for avoiding multiplication of controls at beneficiary level. This principle has been extended compared to previous programming period (Article 148 of the 2014-2020 CPR) to relations between audits (Commission, AA) and management verifications (MAs, IBs). In practice, the application of the single audit principle can be facilitated if supporting documents are available in the IT systems kept by the MAs/IBs.

AAs and the Commission have to first use the information, records and documents in these IT systems, including results of any management verifications performed, in view of their own audits. They would only need to request and obtain additional documents and audit evidence from the beneficiaries concerned where, based on the auditor's professional judgement, this is required to support robust audit conclusions and the documentation available at the MA/IBs level is not sufficient to reach such audit conclusions. This can further reduce the administrative and logistical burden for beneficiaries.

8 System audits and audits of operations versus management verifications

The risk assessment established by the MA/IBs is subject to the AA's system audits (key requirement 4 of management and control systems - management verifications). The adequacy and quality of management verifications can be examined by an AA's system audit. The sample is recommended to be selected from management verifications already carried out. Additionally, the results of the audit of operations also need to be considered in the regular update of the risk assessment.

There is a fundamental difference between the purpose of management verifications performed by the MA and audits performed by the AA or EC and ECA auditors. Management verifications of the MA/IB are part of the MA's internal control function within the management and control system (MCS). Their purpose is to verify that the co-financed products and services have been delivered, that the operation complies with applicable law[19], the programme and the conditions for support of the operation. Management verifications aim to identify and correct irregularities or problems (detected before the inclusion in the payment application) in the expenditure declared by beneficiaries.

Audits are ex-post engagements performed by auditors who are external to and independent from the MA. Audits can reveal whether the management verifications are appropriate as to their design and whether they operate effectively. Audits aim to provide independent reasonable

[19] In line with the provisions of Article 63(1) of CPR, the eligibility of expenditure shall be determined on the basis of national rules, except where specific rules are laid down in, or on the basis of, this Regulation or the Fund-specific Regulations.

assurance on the proper functioning of the MCS and on the legality and regularity of the expenditure declared to the Commission. Control testing is usually performed through *system audits* which look into the design and operating effectiveness of controls by re-performing a number of management verifications. In line with internationally accepted auditing standards and Article 77(1) CPR, auditors must always perform substantive tests in the context of *audit of operations*, but the amount of substantive testing can be reduced if systems and procedures (including management verifications) are found to be working properly.

The main conditions for well-functioning management verifications are that:

- The MCS is classified in category 1 or 2[20];
- There is evidence of an appropriate risk-based approach for management verifications;
- Appropriate management verification checklists are used; and
- Management verifications are properly recorded and documented.

The AAs carry out their audits of operations on the basis of a sample selected[21] from all expenditure declared to the Commission in a given accounting year, regardless of (the results of) management verifications. Consequently, the AA's sample may contain both (1) expenditure subject to previous management verifications and (2) expenditure which has not (yet) been verified by the MA/IB.

A risk-based approach to management verifications may lead to situations where the AA detects irregularities in expenditure declared to the EC that was not verified by the MA. Depending on the magnitude and the (potential) frequency of such irregularities, the AA may consider that this undermines the pertinence of the risk-assessment, the effectiveness of the management verifications as well as the effective functioning of the MCS. The AA will have to assess these circumstances on a case-by-case basis. In any case, if audits find a high frequency of errors and/or a high TER, the AA should advise the MA to review and amend the methodology for risk-based management verifications and possibly increase the coverage of payment claim / operations / beneficiaries in subsequent accounting years.

Any irregular expenditure found – no matter whether this is by the MA or AA - must be corrected[22]. It is also important to examine whether an error is random or systemic.

Finally, it is important for the MA and the AA, after each audit campaign, to systematically review and discuss errors identified by audits and management verifications. This contributes to administrative capacity building and to a joint understanding of the remaining risks and of areas where improvements in the risk assessment and future management verifications can be made.

[20] Category 1 *Works well. No or only minor improvement needed*. Category 2 *Works. Some improvement needed.*
[21] For Interreg Programmes the sample is selected by the Commission (Article 49(6) of Regulation 2021/1059).
[22] Moreover, audits carried out by the AA resulting in an extrapolated total error rate above 2% may imply extrapolated financial corrections, in particular if the correction of individual irregularities identified is not sufficient to reduce the residual error rate to 2% or below.

Annex 1 – EXAMPLES

1.1 – Complex projects

A project can be complex because of its highly technical aspects and/or the way it is structured and managed.

Complex projects will typically have high technical requirements and will require input from more partners or people. Projects can have complex management structures involving internal and external staff, external partners and outsourcing to external contractors.

Factors that influence the complexity of projects:

- Project *type*. A new hospital will be intrinsically more complex than a workshop.
- Project *size*. *Developing (constructing) a new building* for example, tends to be more complex than other smaller projects due to their planning, safety and technological requirements). Also, larger projects will by their very nature require more people to work on them and may necessitate more project management, more sequencing, coordination, organisation, and so on. Larger contracts may mean that more responsibility is transferred to contractors.
- Project *location*. Projects in busy city centres or in remote areas may have to overcome intense planning, spatial and environmental constraints.
- *Political / planning considerations*. Highly-sensitive projects, such as high-speed rail lines, may be opposed by third parties as the project goes through a series of public consultations and enquiries. This may add many years to the duration of a project, resulting in increased complexity, controversy and spiraling costs-
- The method of *procurement* and *financing: a public private partnership* usually involves a potentially complex collaborative arrangement between the public and private sectors to ensure sufficient financing and completion of a project. Complexity may be further increased in *procurement variants* such as design, build, operate and maintain (DBOM) or build, own, operate and transfer (BOOT), where the contractor or developer is to undertake the operation and maintenance of a facility, in addition to design and construction, and transfers it back to the client after a specified time period.

1.2 – Simplified Cost Options ('SCOs')

SCOs are also subject to management verifications (by dully taking into account the legal provisions, e.g. Annex XIII or the provisions of article 94(3) CPR- in case of SCOs used in relation with the Commission).

Methods for the use of SCOs are either pre-defined and agreed in the programme or defined in the CPR. Therefore management verifications related to expenditure under SCOs aim at verifying that the agreed method is correctly applied, and if linked to a number of units (SSUC), that these units are correctly accounted for and justified.

Example:

A MA develops a methodology for a unit cost for persons trained, which is approved by the European Commission together with the programme. The conditions for reimbursement by the Commission detailed in Appendix 1 of Annex 5 CPR foresee the documents necessary to verify the achievement of the units delivered (e.g. lists of presence, attendance certificates, audit trail requested in Annex XIII

CPR). As this is the first time the programme uses simplified cost options, initially the MA foresees an extensive verification of the expenditure covered by this SCO: the MA will verify 75% of the costs / expenditure declared to the Commission. In the first year, the MA identifies some errors (certificates not available for all persons). As the frequency of these errors is limited, the MA decides (when they review their risk assessment) to reduce the frequency of the verifications to 50% in the second year. In order to improve the system, the MA also offers trainings to the beneficiaries to avoid the more frequent errors previously identified in payment claims. In the second year the MA staff encounters no errors. Therefore, in the third implementation year the MA decides not to verify any longer expenditure related to this SCO.

1.3 – Tangible and intangible outputs

Tangible outputs are **physical**.

Examples: Large infrastructure projects. Projects with purchase of land, vehicles, equipment, machinery, furniture, inventory. There is a strong and direct link between input (resources, expenditure) and output.

Intangible outputs. There are no or few physical outputs. There is little or no direct connection between input (resources, expenditure) and output. Hence, there is usually a risk that output cannot be directly or properly measured based on the input of resources and costs.

Examples: projects with intangible outputs often involve trainings, workshops, conferences or publicity campaigns.

Useful output and related documents include for example training records, attendance lists, annotated programmes, reports, meetings and leaflets, which are useful in themselves. Other examples are projects that involve intellectual property, such as patents, trademarks, and copyrights. The output of R&D projects is often difficult to measure as it can be highly technical and at the same time highly intellectual with low or no visible results.

1.4 – Number of projects implemented by a beneficiary

A beneficiary may implement several projects with EU funding. Large organisations with frequent and recurring project applications may implement projects with various sources of EU funding (e.g., ERDF, ESF, RRF, Horizon (Research and Innovation) etc.) and national funding. They may also have other (commercial) activities for which they may or may not generate income.

The issue is that in such situations there is an increased risk that certain costs (or cost items) are declared more than once (the risk of ‘double funding’ not necessarily on purpose), if project cost accounting and cost allocation rules are not clear.

In such cases the management verification should be particularly attentive to a reliable, correct and plausible allocation of costs to the operation, Fund and the payment claim concerned. The best practice approach is to request the applicant to provide full insight and to disclose a cost allocation and overall revenues (reconciled with the beneficiary’s annual accounts) which covers an overview of all costs incurred and allocated to all relevant activities or operations, as well as the different sources of public revenues.

1.5 – Multi-partner projects

Multi-partner projects often involve team members from several organisations (private sector businesses, universities, research institutes etc.) each with their own project management processes (e.g., decision making and communication processes, project management styles)

R&D projects typically involve more partners. Each of those partners carry out one or more tasks and may provide various types of resources being experts (salaries), materials and assets such as specific equipment or machineries or accommodation (factory or testing/laboratory space).

In such cases there is often an increased risk for ineligible costs as one or more partners may be unfamiliar with project cost accounting and/or specific rules (procurement, state aid, eligibility of costs, VAT rules, publicity etc.) that apply.

1.6 – Minimum coverage

As part of the risk assessment, the MA can decide to have a minimum coverage of items to be verified for each selected payment claim, per budget line or type of expenditure. Such a minimum coverage can be set as percentage of expenditure and/or number of items covered by the verifications.

1.7 – Planning of on-the-spot verifications

A population is composed of all payment claims from beneficiaries which are planned to be included in the accounts of a given accounting year. The MA decides that payment claims submitted by beneficiaries in August - October year N will be included in the payment application to the Commission in November year N (i.e., in the accounting year N/N+1). Consequently, as soon as the MA has the information about the operations concerned by these payment claims (to be) submitted by the beneficiaries, the MA drafts the first phase of the plan for the accounting year N/N+1. The plan can then be updated after 4 months with the next phase, covering the next “batch” of payment claims.