



EUROPEAN COMMISSION  
DG Regional Policy  
DG Employment, Social Affairs and Equal Opportunities

## **Guidance document on a common methodology for the assessment of management and control systems in the Member States (2007-2013 programming period)**

### **1. INTRODUCTION**

The objective of this note is to provide practical guidance on the assessment of management and control systems for the Structural Funds and the Cohesion Fund in the Member States. It draws upon the conclusions of a working group which was set up in May 2007 involving staff drawn from the audit services of DG Regional Policy and DG Employment in the European Commission and the European Court of Auditors (the "ECA"), in order to establish a reference framework in terms of:

- defining key requirements of the applicable regulations (Council Regulation No 1083/2006 and Commission Regulation No 1828/2006)
- defining assessment criteria for each key requirement to evaluate the effective functioning of systems;
- providing guidelines for drawing conclusions on the effective functioning of systems for each key requirement and by each authority;
- providing guidelines for reaching an overall conclusion by system on compliance with the regulatory key requirements taking into account any existing mitigating factors or compensatory controls.

This working party sought to promote objectivity, consistency and transparency in the methods of assessment of management and control systems applied by the European audit bodies, i.e. the ECA and Commission audit services. The Commission guidance note also intends to raise awareness of the key requirements and the European audit bodies' assessment methods to staff in all authorities involved (audit authorities, managing authorities / intermediate bodies, certifying authorities/intermediate bodies and beneficiaries).

The national audit authorities are strongly recommended to apply the same approach when evaluating managing authorities/intermediate bodies and certifying authorities/intermediate bodies to ensure harmonisation of audit results and so that auditors in different parts of the control chain can rely on each other's work. The section of the guidance note on evaluation of audit authorities is addressed only to the services of the European Commission.

It is important to underline that the "steps for assessment" methodology described in this guidance note covers the systems audits (i.e. the testing of the key controls) and will allow the auditors to draw conclusions regarding the compliance of the system with the key regulatory requirements.

In order to enable the auditors to express an audit opinion and formulate subsequent actions on the effective functioning of the systems, audits on operations, involving detailed testing of operations at the level of beneficiaries, also need to be carried out. Guidance on audits of operations is outside the scope of this note.

It is not possible in these guidelines to cover all situations which may be identified. The quality review of each audit must ensure that the overall conclusion on the system is substantiated and that the audit opinion proposed is both consistent with the audit findings and properly justified and documented.

The guidance note is accompanied by two annexes: *Annex I* presents the key requirements and the relevant assessment criteria for each key requirement; *Annex II* presents 3 summary tables which should be used by the auditors and which provide the framework for reaching an overall opinion, by system, on the compliance with the regulatory key requirements for the programming period 2007-2013.

## **2. LEGAL FRAMEWORK**

- Council Regulation (EC) No 1083/2006 of 11 July 2006 Title VI Management, monitoring and controls
- Commission Regulation (EC) No 1828/2006 of 8 December 2006 setting out the rules for the implementation of Council Regulation (EC) No 1083/2006

## **3. KEY REQUIREMENTS AND ASSESSMENT CRITERIA**

The key requirements of the management and control systems and the criteria for the assessment of their functioning are included in Annex I. The 15 key requirements and 50 assessment criteria are based on the legal requirements for the 2007-2013 programming period and have been divided by authority.

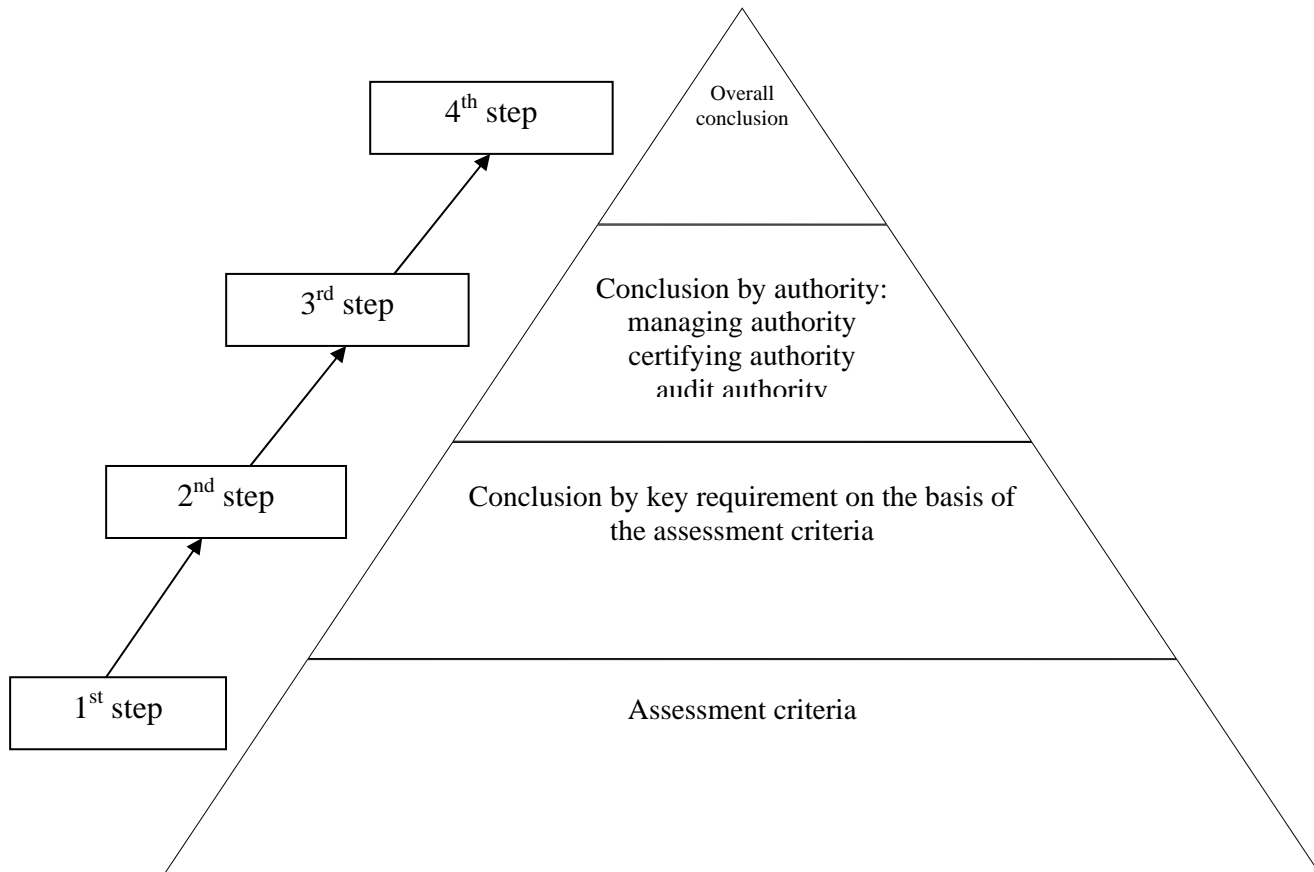
The key requirements concern:

1. The managing authority and any intermediate bodies to which functions have been delegated (7 key requirements);
2. The certifying authority and any intermediate bodies to which functions have been delegated (4 key requirements);
3. The audit authority and any audit bodies that carry out audit work on its behalf (4 key requirements).

The assessment criteria are shown for each key requirement. Non-compliance with these criteria implies a risk of irregular expenditure being certified to the Commission and of over-reimbursement made to Member States.

#### 4. STEPS FOR THE ASSESSMENT

The assessment of the management and control systems follows the schema presented below:



It must be stressed that in all steps of the assessment process, the auditor's professional judgement and effective quality control are essential to ensure consistency of audit results.

Any audit methodology which allows auditors to obtain a high level of assurance and to express an opinion on the functioning of the management and control systems, will comprise systems audits; i.e. compliance testing of key controls at key bodies, complemented by audits of operations on a sample basis. Compliance testing of key controls should be carried out for a number of projects at the level of the managing authority, intermediate bodies, the certifying authority and the audit authority.

The methodology used for the sample selection for key controls testing (such as attribute sampling or judgemental selection) should be decided upon by the audit authority (in the case of Member States), the Commission or the European Court of Auditors respectively. Where a large number of intermediate bodies operate under the same operational programme, an appropriate sample of these can be selected for control testing.

The methodology used for determining the sample size for control testing should be in line with internationally accepted audit standards (eg. INTOSAI, IFAC, IIA). The results of these tests combined with other qualitative elements will form the basis for the assessment.

The working group has defined 4 categories for the assessment of the effectiveness of the key requirements, the authorities and the overall system: “Works well”, “Works but some improvement needed”, “Works partially” and “Essentially does not work”.

- Category 1. **Works well; only minor improvements needed.** There are no deficiencies or only minor deficiencies found. These deficiencies do not have any significant impact on the functioning of the key requirements / authorities / system.
- Category 2. **Works, but some improvements are needed.** Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the key requirements / authorities / system. Recommendations have been formulated for implementation by the audited body.
- Category 3. **Works partially; substantial improvements are needed.** Deficiencies were found that have led or may lead to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant. Recommendations and/or an action plan have been put in place. The Member State / The European Commission may decide to take corrective action (e.g. interruption or suspension of payments) in order to mitigate the risk of improper use of EU funds.
- Category 4. **Essentially does not work.** Numerous deficiencies were found which have lead or may lead to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant – it functions poorly or does not function at all. The deficiencies are systemic and wide-ranging. As a consequence, no assurance can be obtained from the assessment of the key requirements / authorities / system. A formal action plan should be prepared and followed up. The Member State / European Commission take corrective action (e.g. suspension of payments) in order to mitigate the risk of improper use of EU funds.

These 4 categories are systematically used throughout all steps of the assessment process and the 3 tables at Annex II have been designed to facilitate this assessment process.

#### **4.1 Step 1: Assessment Criteria**

The first step consists of evaluating the assessment criteria for each key requirement by determining which of the 4 abovementioned categories best corresponds to each criterion for the operational programme being audited. To ensure a transparent and objective assessment of each criterion, *table 1 of Annex II* should be used.

It is important to emphasise that when categorising each assessment criterion, auditors should apply their professional judgement taking into account any other audit evidence available which should also be analysed. This audit evidence may include:

- All cumulative audit knowledge and experience including information gained from the review of the system descriptions, compliance assessment reports and procedures manuals.
- Information gained from enquiry, observation and from carrying out interviews at bodies involved in the management and implementation of the Funds.

## 4.2 Step 2: Conclusion by key requirement

The second step consists of drawing a conclusion by key requirement on the basis of the assessment criteria previously evaluated under step 1. As a matter of principle, when evaluating the key requirements, the overall impact on the assurance level is a decisive factor. In this context, questions to be asked are: What is the impact of the non respect or partial respect of a particular criterion or key requirement on the identification of errors/irregularities? Does its absence increase the likelihood of irregular or illegal expenditure not being detected?

The following guidance is provided as examples of possible outcomes for this step (after the combination of control testing with other qualitative elements):

- Where one or more assessment criteria are in category 3 (works partially) or category 4 (essentially does not work), the auditor may reasonably conclude that this would not allow for the assessment of the key requirement to be categorised as 'Works well' (i.e. Category1);
- Where a majority of the assessment criteria are in the same category, the auditor may reasonably conclude that this provides a sound basis for also classifying the key requirement in this same category;
- Each key requirement can not be classified more favourably than the worst of the assessment criteria with the possible exception of the following assessment criteria:

### *Managing authority*

Nr 2 Clear definition and allocation of functions

Nr 5 All applications received should be recorded

Nr 6 Decisions should be communicated to the applicants

Nr 15 Where on-the-spot verifications are not exhaustive, the sampling of operations should be based on an adequate risk assessment.

Nr 16 The existence of procedures to ensure that the certifying authority receives all necessary information

Nr 20 Procedures are in place to ensure the availability of documents in accordance with Art.90 of Regulation 1083/2006

### *Certifying authority*

Nr 26 Clear definition and allocation of functions

Nr 33 The certifying authority reconciles and does an arithmetical check of the payment requests.

Nr 35 By 31 March each year as from 2008, the certifying authority shall send to the Commission a statement, in the format in Annex XI of Regulation 1828/2006.

### *Audit authority*

Nr 48 Where the projected error rate is above the materiality level for an operational programme, the audit authority should analyse its significance and take the necessary action.

Nr 50 The annual control report and audit opinion should cover all Member States concerned in programmes under the European territorial cooperation objective.

### **4.3 Step 3: Conclusion by authority**

The third step involves reaching a conclusion by authority, based upon the results of the categorisation of each key requirements under step 2. Tables 2 and 3 of Annex II should be used. Table 2 combines the assessment by key requirement in order to reach a conclusion by authority, while Table 3 which is the 'connection table', links the conclusion by authority to the overall conclusion for the system (link with step 4).

It is impossible to foresee all combinations of assessments of key requirements by authority that might arise. Nevertheless, the following guidance can be given:

1. Each of the the key requirements has to be assessed independently from the other key requirements within the same authority. This means that a weakness in one of the key requirements in one authority cannot be compensated by another key requirement that is functioning well in the same authority. Compensating controls are considered only at the level of the overall assessment of the system. (point 4.4)
2. Some key requirements are essential with regard to the regularity of expenditure and the proper functioning of the relevant authority.
  - managing authority: key requirement 4 – management verifications.
  - certifying authority: key requirement 3 – soundly based certification.
  - audit authority: key requirements 2 and 3 – systems audits and audits on operations.
3. A category 1 or 2 classification of the four essential key requirements referred to in point 2 above would have a positive influence on the overall conclusion, while deficiencies in other key requirements may downgrade the assessment for the relevant authority.
4. If the essential key requirements at point 2 above (or the relevant key requirement for each authority) are classified in categories 3 or 4, the relevant authority cannot be assessed overall in a higher category. In other words, a higher classification of the other less essential key requirements for the authority in question cannot compensate for this deficiency.
5. If some of the functions have been delegated to intermediate bodies, a further breakdown of tables 1 and 2 may be required, in order to reach a conclusion by intermediate body and on that basis, an overall conclusion for the managing or certifying authority.

Auditors should use their professional judgement in order to reach the appropriate conclusion by authority, evaluating the overall picture given in table 2.

### **4.4 Step 4: Overall conclusion**

In this final step, the auditors make the link between the conclusion by authority and the overall conclusion on the system by identifying any mitigating factors/compensating controls that may exist in one authority which effectively reduce the risk in the overall management and control

system. For instance, if the auditor concludes that management verifications in the managing authority (or if delegated, in the intermediate bodies) are incomplete or not effective enough, then verifications carried out by the certifying authority may reduce the risk that irregular expenditure is certified by removing such items before the expenditure declaration is sent to the Commission. It is important to underline that before being taken into account as a mitigating factor or compensating control, evidence of the proper functioning of these controls should be obtained. Another example of a mitigating factor could be an action plan having been implemented which corrects the main irregularities not previously detected by sample checks or management verification checks.

The auditor sets the level of residual risk to the regularity of transactions and finally formulates an overall conclusion, by system, on the compliance of the system with the key regulatory requirements. Table 3 of Annex II should be used.

1. The same categories are used for the overall evaluation of the systems as for the individual key requirements and authorities, to ensure consistency of results at all steps of the procedure.
2. Before setting the level of residual risk to the regularity the auditor must take into account the existence of mitigating factors, as described above.

The overall conclusion by system then provides a basis for determining assurance levels, for formulating audit opinions and subsequent action, taking account of the results of audits of operations.