European Structural Funds

Future Funds 2014 – 2020

Article 60b Expenditure verifications & On-the-Spot Compliance Checks

Lessons Learned Report

Purpose

1.   To identify learning and experience from the 2007 – 2013 European Structural Funds verification and compliance activity which will inform the design of the compliance/verification processes for the future 2014 – 2020 Structural Fund Programmes in Scotland.

Background

2.   The agreed Management and Control System (MCS) for the 2007 – 2013 programmes outlines a four-stage approach to ensuring regulatory compliance. These are:

- Stage 1: Desk Based Checks or On-Site Visits;
- Stage 2: On-The-Spot Visits Under Article 60b;
- Stage 3: Analysis of Findings from the Compliance Checks at Stages 1 and 2;
- Stage 4: Article 62 Work by Audit Authority.

3.   This Control approach outlines a range of progressive and inter-connected checks which are undertaken by the Managing Authority (MA). The purpose of the various checks are to:

- identify and correct irregular expenditure submitted in Progress Reports and Claims (PRC) in a timeous manner;

- identify weaknesses in project delivery and capacity in sponsor organisations; and,

- identify any weaknesses in operational guidance and learning in order to ensure a fully compliant management environment.

4.   This paper will assess the various stages of the MCS and identify areas where lessons could be leant.

Stage 1: Desk Based Checks or On-Site Visits

Outline of Process

5.   The first stage of the MCS process involves desk-based checks by the MA and draws heavily on the information available through the Eurosys IT system. Submitted PRC's with transaction lists are checked to ensure the eligibility of items

on the transaction list and that defrayal dates are correct. Additional checks of a minimum 20% eligible expenditure across cost headings in each claim are undertaken using a random and representative sampling methodology based on EC guidance as per COCOF paper 08/0020/01-EN. This is checked against source documents. Claims will not be declared to the Commission if requested documentation is missing or expenditure cannot be verified. Checks are recorded and documentation held in an agreed data carrier for an agreed period of time.

6.   Identified issues during Stage 1

- the focus of the Stage 1 checks as part of the PRC process has predominantly been expenditure-driven to ensure compliance with the National Expenditure rules. Other elements of project performance have not always been as thoroughly assessed during this stage;

- information-gathering on issues such as procurement and publicity have not been systematically done at this stage but have been deferred to the Article 60b on-the-spot visits;

- the lack of a standardised applicant transaction list template at the commencement of the 2007 – 2013 Programme allowed applicants to provide essential support information for the Stage 1 process to be provided in an inconsistent manner;

- some problems have been identified during the Article 60b visits with the validity and transparency of staff costs included on projects. These were not highlighted during the Stage 1 expenditure checks as job descriptions were not always routinely scrutinised as part of the process; and,

- the use of real costs in project applications has increased the length of time it takes for SG staff to complete 20% expenditure verifications due to the number of transactions required to make up the sample. It is also caused issues for applicants who are required to secure a clear audit trail for all expenditure declared.

7.   As a result of the above identified issues a number of recommendations have been made to improve the Stage 1 process.

Recommendation 1: It is important that a more thorough assessment on all aspects of project performance and documentation is undertaken during the payment of interim PRC's to provide early warning of potential implementation issues. The gathering of information on issues such as procurement, state aids, publicity and staffing structures will better inform the efficient operation of the Stage 2 and Stage 4 processes.

Recommendation 2: Standardised templates should be provided by the Scottish Government to all applicants at the commencement of the programme period.

Recommendation 3: A movement to a either a Simplified Cost methodology or procurement cost approach in the 2014 – 2020 Programmes would reduce the administrative burden associated with the verification of project expenditure in both the Scottish Government and applicant organisations.

Stage 2: On-The-Spot Visits Under Article 60b

<u>Outline of Process</u>

8.   The second level of control consists of on-the-spot verifications. Visits are carried out by the MA portfolio managers and experienced compliance managers. Prior to any officers undertaking an on-the-spot-verification, they will attend an intensive training course that has been developed with input from the MA and IAB and supported by appropriate experts in, for example, procurement, state aids, finance and accounting.

9.   As European Social Fund (ESF) projects typically involve a limited number of sponsors with a multiplicity of similar projects, while European Regional Development Fund (ERDF) projects tend to be dissimilar ones from different sponsors, a different approach has been adopted for selecting projects for on-the-spot visits for the two separate funds. In respect of ESF, the Scottish Government <u>aims</u> to ensure that projects from 100% of all sponsors are visited, on the understanding that, if significant or potentially systemic errors are identified in one project from a particular sponsor, checks on further projects sponsored by that organisation may be made to see if there is a case for extrapolation of the finding. If a sponsor has more than one project then a single project will be randomly selected from the list of projects and this will be the project visited. In respect of ERDF, the Scottish Government aims to visit 100% of projects. Visits will be spread across the lifetime of the programme in order to ensure that an acceptable level of expenditure is verified on-site and that projects are visited at different stages of the project lifecycle.

10.   In the case of both funds, the Stage 2 checks will verify the reality of expenditure and check compliance with the previously approved guidance on project selection and appraisal as well as tendering/procurement, state aids, horizontal themes, revenue generation, outcomes and publicity. Beneficiary costs are also checked, if appropriate. A minimum of 20% of expenditure declared at the time of the visit will be verified on-site, with a sample of declared expenditure selected prior to the visit, and financial checks will include a systems audit of the final recipient, where appropriate. In order to achieve greater consistency, visiting officers will hold a wash-up meeting with the project sponsor on the day of the visit and highlight any issues identified. Where appropriate, all will agree the follow-up actions required and set out a timescale for resolution – maximum of 20 working days. When no issues remain to be resolved or the timescale has elapsed, a report will be issued to the project sponsor within a further 20 working days. The report will detail any issues and explain the next steps. MA will undertake any necessary recovery action.

11.   The level of checking set out above is indicative and is proposed at the beginning of the programme in the absence of evidence levels and accuracy of claims and error rates. While it represents the clear intention, it is subject to change

in the light of experience. If the evidence emerging from Stage 3 supports an adjustment to the level or type of checks required, the MA will propose and agree amendments with the Audit Authority.

12. <u>Identified issues during Stage 2</u>

- there were delays in agreeing the Management and Control System (MCS) which was not finalised until the end of 2009 and agreed visit targets have proved challenging;

- there were delays in publishing the National Rules of Expenditure which led to numerous problems with expenditure i.e. documentary evidence and retention; incorrect hourly rate calculations; lack of time sheets; incorrect match funding evidence etc;

- there has been an ongoing issue of queries, clarification and problems with the National rules Q & A which have not been dealt with promptly or at all. When advice was given this was often not disseminated fully internally and/or externally;

- there has been a general issue with 60b team auditing projects late on in the project life or after the project has finished, mainly caused by the volume of projects to visit;

- weaknesses in the understanding of Procurement requirements – limited discussions with sponsors up front to ensure they understand procurement and what is expected of them in terms of process and what has to be retained. Also need to ask sponsors to retain a record of all contracts procured;

- a need to ensure State aid are looked at early on in project development;

- a lack of prescriptive guidance around ESF projects led to poor systems, lack of clarity around participants – what level of engagement constitutes support, double counting, inconsistent understanding and application of output/result targets;

- an inconsistency relating to how the Horizontal Themes have been addressed. Despite the focus given to them by the Commission, problems have included out of date guidance; failure to follow through on poor justification at application stage; lack of understanding/prioritising in the Managing Authority; and poor evidence from sponsors at 60b check;

- too many approved projects which has reduced the time available to staff to fully understand the issues; and,

- a lack of clarity regarding the document retention requirements. By the time an Article 62 or 60b visits takes place a project may have closed and documentation such as participant records or some receipts may be missing

etc. It is important that clear guidance is prepared to ensure robust systems are in place in terms of retaining evidence.

13. As a result of the above identified issues a number of recommendations have been made to improve the Stage 2 process.

Recommendation 4: The MCS for the 2014 – 2020 Programme period must be completed as quickly as possible with a realistic auditing regime and targets. There also needs to be a clear separation between the Managing Authority/Compliance Team checks and Internal Audit Division (IAD) checks to avoid duplication.

Recommendation 5: National rules for expenditure must be issued at the start of the Programme and must be clear, comprehensive and communicated to stakeholders. The National rules should be reviewed on a regular basis by the Scottish Government and operational issues discussed internally to ensure a consistency of interpretation.

Recommendation 6: The Q&A is a useful tool but the responsibility of updating this has changed so much that it has not been updated on a regular basis. Regular compliance forums to discuss issues and reach consensus decisions also need to be held regularly.

Recommendation 7: Compliance regime should start at project conception and carry on throughout the project life time. However, this may not be such an issue in the new Programmes if there are fewer, larger projects.

Recommendation 8: All procurement processes and documentation need to be checked and validated by SG staff experienced in dealing with public procurement before any payments of grants are made. This is to avoid late checking and finding procurement issues well into the lifetime of the project, which results in recovery of funds and possible de-commitments.

Recommendation 9: SG State Aid Division has to be involved from project conception stage to advise on potential state aid issues.

Recommendation 10: Clearer guidance about what we expect to see from ESF projects with regard to participant reporting needs to be clear at the beginning.

Recommendation 11: Clearer guidance about what we expect to see with regard to horizontal themes needs to be clear at the beginning.

Recommendation 12: SG staff (both Compliance managers and portfolio managers) need time to understand often complicated projects and deal with the issues that come from checks. There is scope for thematic or targeted checks, looking at specific aspects of project delivery or systems. This has been needed in the current Programme to address potential or emerging issues.

Recommendation 13: It is important that audit retention information is clearly defined at the start of the Programme.

Stage 3: Analysis of Findings from the Compliance Checks at Stages 1 and 2

<u>Outline of Process</u>

14.   The issues arising from Stages 1 and 2 are examined at regular Monitoring Meetings, at which the Managing Authority, Certifying Authority and Audit Authority are represented. These meetings of the Compliance Monitoring Group (CMG) allow the Scottish Government to identify common or potentially systemic errors and assess the quality of information provided by the checks. The Audit Authority attend in an advisory capacity and offer insight to findings emerging from Article 62 work. These meetings also allow an exchange of information and best practice and ensure a consistent approach is taken by all parties involved in compliance checks. One of the key outputs of Stage 3 is to determine whether the level and type of checking is sufficient to offer the level of assurance on the reality and eligibility of the expenditure, as required by the regulation.

15.   In summary the remit of the Compliance Monitoring Group is to:

- share and review information on compliance activity undertaken including summary of conclusions;
- ensure that issues can be addressed in an agreed and considered manner and implemented across all funds as appropriate. It also provides for the exchange of information and best practice; and,
- Finally, it confirms the stringency of the controls in place to enable the Certifying Authority to submit a Payment Request to the Commission, and the Audit Authority to give the annual assurance required under Articles 58-62 of Council Regulation 1083/2006 and Section 3 of Council Regulation (EC) 1828/2006.

16.   <u>Identified issues during Stage 3</u>

- Issues found during Stage 1 and Stage 2 checks are not always particularly well fed back. This is especially the case if the issue is resolved prior to the report being finalised as it won't necessarily be recorded. This can partly be due to the personal style of the visiting compliance team but has resulted in a missed opportunity to analyse the problem;

- The Control sheet used to record all issues identified on Article 60b visits has not always been kept updated by Compliance Managers in a timeous manner;

- The internal Compliance Team meetings have not always analysed the new emerging issues identified on recent visits which has reduced the opportunity to discuss them at the Compliance Monitoring Group;

- There have been delays experienced in updating the text of the MCS documents to record changes in organisational structure and operational processes; and,

- Some papers for the CMG have been circulated at short notice which has reduced the opportunity for members to fully assess the information.

17.   As a result of the above identified issues a number of recommendations have been made to improve the Stage 3 process.

Recommendation 14: SG systems for recording and monitoring compliance activity needs to be kept updated to enable early discussion of emerging issues and all papers for CMG meetings need to be circulated by agreed deadlines.

Recommendation 15: The MCS should be reviewed on an annual basis to ensure it accurately reflects operational implementation and should be signed-off by the CMG.

Stage 4: Article 62 Work by Audit Authority

Outline of Process

18.   The Scottish Government Internal Audit Division acts as the Audit Authority (AA) in terms of Article 62 of EC Regulation 1083/2006. Its functions are as follows:

- ensuring that audits are carried out to verify the effective functioning of the management and control system;

- ensuring that audits are carried out on operations on the basis of an appropriate sample to verify expenditure declared; and,

- presenting to the Commission within nine months of the approval of the operational programme, an Audit Strategy covering the bodies which will perform the audits, the methods used, the sampling method for audits on operations and the indicative planning of audits to ensure that the main bodies are audited and that audits are spread evenly throughout the programming period.

19:    Identified issues during Stage 4

- all four Structural Funds Programmes have had their payments from the Commission either interrupted or placed under the threat of interruption in the last year. This action was a result of Commission audits of the verification work carried out on-site at projects by SG's Internal Audit Division (IAD). In particular, the Commission's audit raised concerns about the low error rates reported by IAD following its visits to projects and about the robustness of the audit trails being retained and recorded by IAD, ESFD and project beneficiaries. Behind the Commission's concerns is a view that the structure of the programmes originally devised by ESFD in 2007 was unduly complex and that this has contributed to difficulties in the review processes. As a result, all processes for the Stage 1 Expenditure Checks, Article 60b and Article 62 have been reviewed and identified deficiencies in forms and

guidance addressed. Additional resources were also made available to IAD to meet Commission deadlines aimed at lifting the payment interruptions;

- a recognition that communication between the MA and IAD needs to be improved. Arrangements have now been put in place to ensure we work more effectively together. This involves regular meetings and actively encouraging staff to call and talk to each other regarding identified issues;

- there have been problems identified in co-ordinating Article 60b and Article 62 in terms of planning and resourcing visits;

20.   As a result of the above identified issues a number of recommendations have been made to improve the Stage 3 process.

Recommendation 16: Ensure all forms and guidance used to undertake the various stages of Compliance are developed at the commencement of the 2014 – 2020 programme period. All resource and training requirements need to be defined in advance. A failure to satisfy Commission auditors regarding the robustness of agreed processes identified in the MCS could result in future payment interruptions to the Scottish Government and associated reputational damage.

Recommendation 17: Ensure effective communication between the MA and IAD to discuss and resolve issues identified on Article 62 visits. This should be done through regular meetings at both a senior and operational level. Although separate regulatory requirements, identify areas for closer co-operation between Article 60b and Article 62.