



# Risk based management verifications Article 74 (2) CPR 2021-2027<sup>1</sup>

## REFLECTION PAPER

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<sup>1</sup> **DISCLAIMER.** This reflection paper was prepared in view of a workshop with ETC authorities in December 2020 by and expresses the view 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.

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## Abbreviations

AA	Audit Authority
AMIF	Asylum, Migration and Integration Fund
BMVI	Border Management and Visa Instrument
CF	Cohesion Fund
CPR	Common Provisions Regulation
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	Implementing Body
ISF	Internal Security Fund
MA	Managing Authority
MCS	Management and Control system
OP	Operational Programme
SCO	Simplified Cost Options
TER/RTER	Total Error Rate / Residual Total 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 (2) Common Provisions Regulation ‘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 General principles – new elements

This document is a reflection paper the objective of which is to provide general guidance and direction on certain important aspects of the application of Article 74 (2) CPR regarding management verifications applicable to all the funds governed by the CPR including the ERDF (European Regional Development Fund), the European Social Fund+ (‘ESF+’), the Cohesion Fund, the European Maritime, Fisheries and Aquaculture Fund (‘EMFAF’), the Asylum, Migration and Integration Fund (‘AMIF’), the Internal Security Fund (‘ISF’) and the Border Management and Visa Instrument (‘BMVI’). The document provides examples and best practices which can be used by Managing Authorities (‘MAs’) and their Implementing Bodies (‘IBs’), considering their own organizational structures and control arrangements and the specificities of each management and control system, the risks identified and the needs of each Operational Programme (‘OP’)<sup>2</sup>.

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<sup>2</sup> Hence, this document is primarily intended for Managing Authorities and Implementing Bodies but it can also be a useful reference tool for Audit Authorities.

The purpose of this document is not to provide detailed guidance and support tools (including for example formats for a risk assessment strategy, templates, risk assessment grids etc.) for performing risk-based management verifications. Each MA is responsible for developing and implementing its methodology in line with the directions in this paper and considering the relevant aspects of the OPs and the specific context in which these are implemented.

**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 OP, the related management and control system and the risks identified.**

MAs and IBs will carry out management verifications under Article 74 (1) and (2) CPR, to verify the delivery of the co-financed products and services, the reality of expenditure claimed for reimbursement and the compliance with the terms of the relevant Commission Decision approving the OP and applicable Union and national law<sup>3</sup>, as well as the conditions for support of the operation. These management verifications include **administrative verifications** in respect of payment claims by beneficiaries and **on-the-spot verifications** of operations.

The new elements in the CPR provisions (in comparison to 2014-2020 framework) are:

- Both administrative and on-the spot management verifications **are risk-based** and proportionate to the identified risks,
- The managing authority prepares **ex-ante and in writing the 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) included in the ex-ante risk assessment for the accounting year are **carried out before submission of the accounts**<sup>4</sup>.

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<sup>3</sup> Provisions for **Interreg**. Article 46(3) of Regulation (EU) 1059/2021 (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. In order to ensure equal treatment and considering the cooperation goal of these programmes, risk assessments made by controllers should be reviewed and approved by the Managing Authority. Any difference in approach between Member States should be duly justified.

<sup>4</sup> Article 74 (2) CPR has a specific legal requirement which stipulates that ‘...*Those verifications shall be carried out before submission of the accounts in accordance with Article 98.*’ The CPR for the 2014 – 2020 programming period does not have such an explicit legal requirement although the EGESIF Guidance of (EGESIF\_15-0002-04 of 17/12/2018, 6 Management Verifications – Section 1.6 Timing of management verifications) sets out that ‘*No expenditure shall be included in the certified accounts submitted to the Commission if the planned management verifications are not fully completed and the expenditure is not confirmed as legal and regular.*’

Management verifications by MA/IBs should also cover durability requirements. However, the verification of these requirements can normally only be performed after the expenditure concerned has been certified in the accounts.

Consequently, for **both administrative and on the spot verifications**:

The ex-ante risk assessment defines the **risk factors/criteria** (e.g., type of beneficiary, experience, complexity of the operation, results of past audits/controls, value of items, etc.) for the selection of operations and payment claims. The MA may also define a certain coverage<sup>5</sup> of the management verifications. **Example 1.1- Risk typology.**

The **rationale** of performing an ex-ante risk assessment is to focus management verifications on the risks identified at the level of the operations, beneficiaries and payment claims. This means that, unlike in the period 2014 – 2020, **not all payment claims from beneficiaries and not all operations have to be subject to a management verification.** A 100% verification of a population of payment claims and of the expenditure within payment claims is possible, if this is duly justified by the risk assessment.

Within a payment claim or operation, **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 material error is high.

The risk assessment may be performed **at different levels.** The MA/IB may identify the main risks, which can be related to an OP, priority axis, type of operation, beneficiary or type of expenditure.

The risk assessment and the methodology to identify the operations, payment claims and expenditure items to be verified, are **established ex-ante and in writing** by the MA/IB.

The methodology and the risk assessment include an analysis of the risk factors and indicate the conditions and factors for a regular **revision.** Such a revision should take into account the results of previous administrative and on the spot verifications, findings arising from work of other control/audit bodies (AA, Commission auditors and the European Court of Auditors ('ECA')) and external factors that could have an impact on the implementation of operations (e.g., potential conflicts of interest and concerns reported in media).

The MA is fully responsible for organising its capacities and resources and those of its IBs to ensure that management verifications (both administrative and on-the -spot) cover sufficiently the risks identified and are **carried out in time before submission of the accounts** in a way that the results of the management verifications are reflected in the accounts.

Good communication between the MA and AA is important. They can informally discuss their methodologies and the MA's risk assessments to have a mutual understanding and with a view to enhance the quality of the MA's risk assessment methodology. The AA can provide

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<sup>5</sup> For example by setting a minimum % of expenditure/operations to be checked or setting up a risk score/category above which the operation/expenditure would be subject to verification.

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recommendations on the MA's risk assessment methodology, and it is up to the MA to take these into account. The risk assessment improves 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 outsourcing of the risk assessment is not appropriate. The final responsibility for the risk assessment methodology remains with the MA.

A multiplication of controls at beneficiary level should be avoided if this is not in contradiction with the risk assessment strategy (for management verifications) of the MA and the audit strategy of the AA, also taking also into account the provisions of Article 80 on single audit arrangements. Both the AA and the MA need to comply with their responsibilities and strategic principles.

#### Training and capacity building

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

#### Organisation of management verifications

Management verifications<sup>6</sup> can be performed at the levels of the MAs and/or IBs. It is advisable to have separate and independent functions for the selection of operations on the one hand and for the management verifications on the other hand, as much as possible. This contributes significantly to objective and adequate verifications.

### **3 Risk assessment during appraisal and selection of operations**

Most MAs carry out some form of assessment of risks related to the operations at the stage of selection and appraisal of operations. For the purpose of appraisal, selection and approval of operations the MA<sup>7</sup> or IBs ensure that applicants have the financial resources before an approval decision is taken. Other conditions related to the operational, technical and administrative capacity of the applicants are also considered as these may increase the risk for later management verifications. In practice the MA usually considers and assesses (levels of) risks and this is often recorded in checklists, project appraisal forms and/or other documents used in the project selection stage.

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<sup>6</sup> Those are the set of specific verifications (administrative and on-the-spot checks) carried out in conjunction with the management and implementation to verify compliance with legality and regularity, the fundamental principle of sound financial management and correct execution of operations.

<sup>7</sup> For Interreg Programmes, these tasks are for the Monitoring Committee (art. 22(4)(d) of Regulation 1059/2021).

In a risk-based approach to management verifications it is highly advisable to have a formal and systematic risk assessment at the selection and appraisal stage of operations and to integrate this in the MA's risk assessment methodology.

The MA/IB may consider the following (non-exhaustive) potential risk elements at operation and at beneficiary level at the stage of appraisal and selection of operations:

### **At the level of operations**

- ✓ Operations with a significant budget,
- ✓ Nature and complexity of the project (infrastructures, studies, equipment, etc.), type(s) of expenditure, legal requirements applicable (e.g., public procurement, State aid, simplified cost options ('SCOs')<sup>8</sup>, Financial Instruments ('FIs')<sup>9</sup>, use of financing not linked to costs ('FNLC') etc.) and changes in legislation and administrative capacities. **Example 1.2 – Complex projects** and **1.3 – Simplified Cost Options**.
- ✓ 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 1.4 – Tangible and intangible outputs**
- ✓ On-the-spot ('OTS') visit not possible or delayed (e.g., COVID pandemic, other reasons)
- ✓ Operations approved and started near to the end of the programming period
- ✓ Operations which had already started before selection or which are close to completion
- ✓ Operations implemented in different locations. **Example 1.2 – Complex projects**
- ✓ Umbrella projects i.e., over-arching projects to ensure integration and coordination of all sub-projects other than the umbrella project
- ✓ Output indicators not available / reported until the operation has been completed
- ✓ Duration of the operation (multi-annual projects)
- ✓ Delays in implementation
- ✓ Dedicated and competent project manager in function within the structure for setting up and monitoring the operation
- ✓ Number of different cost categories. **Example 1.5 – Project cost breakdown structures and number and type of cost categories**
- ✓ Number of project modifications

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<sup>8</sup> For example : the use of SCO's may involve low, medium or high risk depending on the complexity and specific features of the accounting system, the number of (different types of) SCO units used and the experience of the beneficiary with the use of SCOs.

<sup>9</sup> For example: FIs' expenditure does in general not necessarily involve higher risks. However, in some cases they tend to have complex set-up and various actors and organisations involved in the implementation.



### At the level of beneficiaries

- ✓ 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 projects implemented by the same beneficiary. **Example 1.6 – Number of projects implemented by a beneficiary**
- ✓ Number of partners in the project. **Example 1.7 – Multi-partner projects**
- ✓ Beneficiary's capacity to implement the operation
- ✓ Experience with the beneficiaries in implementing projects
- ✓ Change of beneficiary during project implementation
- ✓ Amount of the beneficiary's own contribution

For the purpose of identifying risks at beneficiary level the MA may refer to IT tools such as national systems under Article 69.8 and Annex XIV CPR, datamining tools (e.g., Arachne) and open data platforms under Article 49A CPR (e.g., Kohesio).

### Both levels

- ✓ Type, legal status and ownership structure of the beneficiary
- ✓ Level of risk of potential conflicts of interest

## 4 Administrative verifications of beneficiaries' payment claims

The administrative verifications of beneficiaries' payment claims are performed taking into account the financial implementation of the operations. Therefore, they are carried out within a reasonable time frame after a payment claim is submitted by the beneficiary.<sup>10</sup>

The Commission's guidance on the treatment of errors (ref. EGESIF\_15-0002-04) incentivizes early detection of irregularities by the MA. If the irregularity is identified and corrected before the AA draws its sample of operations to be audited, the error does not need to be projected, and hence the error does not increase the total error rate / residual total error rate (TER/RTER) to be calculated by the AA and/or the Commission's audit services. This is obviously in the

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<sup>10</sup> See Art. 74(1) (b). The beneficiary should receive the amount due in full and no later than 80 days from the date of submission of the payment claim by the beneficiary.

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common interest of the national authorities. Consequently, early management verifications (even before the MA submit the expenditure to the Commission), in particular before the AA draws its sample (even if the MA's risk-based sample does not fully overlap subsequently with the AA's sample, there may be some common items) are encouraged. The detection of an irregularity by the MA after the AA has drawn its sample of operations has to be extrapolated when the AA calculates the Total Error Rate ('TER').

In this respect it is important to stress that the MA's risk-based management verifications differ fundamentally from the AA's audits of operations. Errors found by the AA can be projected as the AA's audit sample is random, usually a statistical one. This is not the case for the MA's sample. Hence, errors cannot be projected and the MA should correct those errors that are effectively identified by the MA's management verifications. But the MA should also assess any systemic impact of the errors it detects, at the level(s) of operations/beneficiaries, measure or OP.

The MA may therefore reduce risks upstream and prevent errors to occur by drawing lessons from past errors. MAs may consider providing further and targeted guidance to beneficiaries (e.g., concerning calls, assistance during implementation) and hence contribute to a further strengthening of KR 3 (Adequate information to beneficiaries). MAs may also consider further capacity building at the level of beneficiaries e.g., by providing targeted training and information sessions.

A **risk assessment** of all the approved operations, including the risk criteria and the weighting of these, is prepared in writing **before** the payment claims for these projects are submitted to the MA and the administrative verifications start.

To ensure that administrative verifications of payment claims are carried out **before submission of the accounts** in which the expenditure is certified, the MA draws up an indicative "*Administrative Verifications Plan*" for each accounting year on the basis of the following elements:

- The results of the risk assessments at the selection of operations stage;
- The estimated timing of the submission of the payment claims based on the (indicative) timetables for the implementation of the project phases and the related financial forecasts in the approved operation/project applications; and
- The deadlines (number of days) by which administrative verifications must be performed to comply with the requirement on payment delays (otherwise the MA needs to notify the beneficiary concerned of a suspension of payment delays).

### **Selection of payment claims for administrative verifications**

The selection of payment claims and supporting documents will be performed on the basis of **risk** criteria established by the MA.

**As a first step for the selection of payment claims** for administrative verification, the risks identified at the selection of operations stage are considered. The MA may refer to **Arachne or other data mining tools** if available, as these may provide useful information on risks of fraud and/or irregularities. In this context, such tools primarily serve as a risk assessment support tool.

Moreover, the following payment claims could be considered to avoid the risk of irregularities being identified in a later payment claim affecting also previous payment claims:

- ✓ First payment claim of the beneficiary<sup>11</sup>, so that the MA can assess any risks associated with the specific project and/or beneficiary,
- ✓ First payment claim(s) containing expenditure under SCO, staff costs, FIs, etc.,
- ✓ First payment claim(s) containing expenditure for procurement contracts,
- ✓ Payment claims for operations for which potential risks were identified during the selection of operations.

The results from any previous verifications and audits are taken into account. The MA may also consider the risks related to the financial value of a claim or its percentage of the total approved costs of the operation (e.g., resulting in an administrative verification of all claims above a certain value).

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

As a first step, the MA reviews the expenditure listings submitted by the beneficiary (with details of all expenditure 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 the selected payment claim(s) entirely (100%), the selection of expenditure items in the payment claim (e.g., staff costs, procured items, etc.) is to be performed on the basis of the prior risk assessment performed by the MA. In this regard, expenditure items that, in the opinion of the MA, have a higher inherent risk, are unusual or give rise to suspicion of fraud or exceed a certain amount or percentage of the total costs declared under the budget line in this claim, could be considered for verification. The rules and 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 / type of expenditure in the payment claim. The MA may decide to establish a minimum number of items to be verified.

#### **Example 1.8 – Minimum sample size/coverage**

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<sup>11</sup> This case may not be applied when the first payment claim includes only advance payments. The MA may also refer to a risk assessment which was carried out at appraisal stage.

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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 select a sample of items to be verified. The MA's risk assessment and verification procedures should specify the approach to be taken when irregularities are identified in verified items. The sample of verified items may be extended, if necessary up to 100%. This paper does not provide a sampling methodology but sampling and rules for extension of samples (depending on the results of verifications carried out) can be addressed in the MA's risk assessment paper if a MA wishes to apply sampling at the level of the selected beneficiaries/payment claims.

#### **Example 1.9 – Random sample**

A risk-based approach can also be applied for example for the verification of, public procurement (in case this is done with the administrative verification of payment claims) does not necessarily need to cover all public procurement procedures. When assessing the risks, it is recommended to consider the value of the contracts (i.e., with regards to the EU thresholds) 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.

#### **Full (100%) administrative verification**

In some cases, the MAs may want to consider the possibility to maintain a full i.e., 100% administrative verification. Article 74(2) CPR sets out that management verifications shall be risk-based and proportionate to risks identified ex ante and in writing. Consequently, a 100% verification (i.e., of payment claims or of expenditure items within payment claims) is still possible if this is duly justified on the basis of a risk assessment. However, a 100% verification is not recommended, as the purpose is to rationalise the management 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).

A less than 100% administrative verification involves in principle a risk that certain errors will not be identified. This is the essential feature and consequence of a risk-based approach to management verifications. It is also the main reason why the MA draws up a written and reasoned risk assessment, which explains on the basis of which method and criteria risks and levels of risks are acceptable. The statistical sampling carried out by the AA aims at confirming whether the MA's risk assessment was effective in preventing errors occurring or whether it needs to be strengthened.

For the MA, as the responsible manager of an OP, the objective is to be able to draw a conclusion from the management verifications performed also if these do not cover 100% of all the claims (to be) submitted to the Commission. The MA certifies all expenditure in the claims that are submitted to the Commission including the part that the MA have not effectively verified. Consequently, the MA's risk-based verification should be such that the MA must obtain 'assurance' ('assurance' here meaning sufficient and satisfactory verification results) for 100% of the expenditure which is

submitted to the Commission though the MA may not effectively verify 100% (i.e. not all claims and/or not all expenditure within a claim).

The MA can declare the expenditure legal and regular if it considers that the risk-based verifications performed sufficiently cover the risks and hence the ‘assurance’ obtained is reasonable. Depending on the verification results, the MA may conclude that risks are sufficiently covered or that verification work should be extended until sufficient and reasonable ‘assurance’ has been attained. This is primarily 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 the latter case the MA is expected to adapt its risk assessment methodology and verification approach.

## 5 On-the-spot verifications of operations

On-the-spot verifications cover in particular the risks related to the reality of the operation and expenditure, the delivery of the product or service in compliance with the terms and conditions of the agreement, physical progress and respect of the EU rules on publicity<sup>12</sup>. An on-the-spot verification also allows checking whether the beneficiary provides accurate information on the physical and financial implementation of the operation. Consequently, on-the-spot verifications should preferably be undertaken when the operation is well under way, both in terms of physical and financial progress.

For that purpose, the MA<sup>13</sup> draws up an “*On-the-Spot Verifications Plan*” for each accounting year and, if needed, updates it during the year taking into account (changes in) the implementation progress of the operations.

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

The population subject to possible On-the-Spot Verifications includes all operations for which expenditure is expected to be included in the accounts of the accounting year concerned (i.e., expenditure entered in payment claims to be submitted to the Commission in that accounting year). The MA may decide not to carry out on the spot verifications for operations which according to the risk assessment are not considered as risky.

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<sup>12</sup> In case of breach of EU rules on publicity (Art. 50.3 of the CPR), this could lead to financial corrections,

<sup>13</sup> In case of Interreg Programmes, the controllers may draw up the “on-the-spot verifications plan” but the MA should approve it.

The planning of on-the-spot verifications can be split in phases, for example every tri-/semester of the accounting year.

The MA can plan the on-the-spot verifications as soon as it has 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 verification with an on-the-spot verification.

Given that administrative verifications are also risk based, some operations/payment claims may be subject to an on-the-spot verification without a preceding administrative verification. In such cases it may be useful to carry out an administrative verification before the on-the-spot verification is performed to obtain a full background and understanding for the on-the-spot verification. It is important that the combination of administrative (desk based) and on-the-spot checks ensures a sufficient mitigation of risks.

**As a first step for the selection of operations** for an on-the-spot verification, the risks identified at the selection of operations stage and during administrative verifications, if any, should be considered. The MA may also refer to **Arachne or other data mining tools**.

Moreover, the MA/IB may consider the following (risk) elements when selecting the operations for on-the spot management verifications:

- ✓ 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,
- ✓ Operations with problems identified by the MA/IB through monitoring, for example in progress reports. Such problems may relate to financial corrections, delays in implementation, suspicions of fraud, complaints, etc.,
- ✓ Operations where audits and previous controls have identified progress/reporting problems, irregularities, or suspicions of fraud.

### **Selection of expenditure items within the operation**

For operations which are implemented over several years, an on-the-spot verification can cover the entire operation (or part of it) implemented up a certain point in time regardless of the accounting year in which the related payment claims were submitted to the MA.

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

- ✓ If a group of beneficiaries implements the operation, only the part of the operation implemented by some of the project partners may be selected.
- ✓ Where the selected claims contain many expenditure items/invoices (and depending on the scope of the administrative verifications), the on-the-spot verification may cover only some of these items or aspects (for example, checking physical existence or examining public procurement), similarly as set out above in the “administrative verification” procedure.
- ✓ In case 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. 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.
- ✓ Similarly, to administrative verifications, if the risks are the same for a certain type/category of expenditure, the selection of items for this type/category of expenditure can be done randomly. For example, if there are similar machineries in a project, the MA may select a sample of machines to verify their existence on-the-spot.

## 6 e-Cohesion

The introduction of e-Cohesion<sup>14</sup> (CPR Article 69(8)) aims to simplify and streamline the implementation of funds governed by the CPR. Electronic data exchange systems allow the secure exchange of born-digital<sup>15</sup> 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 can have important benefits:

- ✓ It can significantly reduce the administrative burden both for beneficiaries and local administrations.
- ✓ 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.

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<sup>14</sup> For EMFAF, AMIF, ISF and BMVI the use of e-Cohesion mandatory as of 1 January 2023

<sup>15</sup> Born-digital records are records that have been natively created in digital format (rather than digitised from paper records).

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- ✓ It can enhance controls in that 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 e-Cohesion also allows to create and maintain **adequate electronic audit trails**, which comply with relevant requirements on the availability of documents (CPR Articles 69(6), 82 and Annex XIII). Consequently, **e-Cohesion** and Electronic data exchange systems - also used in the context of management verifications - can **significantly contribute to reducing the audit and control burden**.

## 7 Audit trail

Management verifications should be performed with adequate arrangements for documentation and the keeping of electronic audit trails. The use of e-Cohesion can enhance these arrangements. If these conditions are met, the **audit burden for beneficiaries can be significantly reduced**.

### Availability of documents

As a basic rule, documents are 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 their payment claims along with all related supporting documents (in electronic form) to the dedicated IT systems managed by the MAs/IBs if this is possible (CPR Article 69.8). The systematic uploading of supporting documents at all times is highly recommended even if the related payment claim is not going to be made subject to an administrative verification. This facilitates 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.

### Single audit arrangements

The single audit arrangements (CPR Article 80) remain an important principle for avoiding multiplication of controls at beneficiary level. This principle has been extended 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 electronic form) in the IT systems kept by the MAs/IBs.

In this way, AAs and Commission auditors can first use all the information, records and documents in these IT systems, including results of any management verifications performed. 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. This further contributes to reducing the administrative and logistical burden for beneficiaries.

## 8 System audits and audits of operations versus management verifications

The MA's risk assessment methodology is subject to the AA's system audits of KR4 (management verifications) when such audits are carried out. The adequacy and quality of the management verifications will be examined by an AA's system audits on the basis of a sample selected from the management verifications already carried out.

There is a fundamental difference between 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 MCS. The purpose of these checks is to identify errors in the payment claims of the beneficiaries and to correct them (preventive role).

Audits are ex post engagements performed by professional auditors who are external to and independent from the MA. Audits can test whether the management verifications as defined in CPR Article 74 function properly. Audits aim to provide independent assurance on the proper functioning of the Management Control System ('MCS') and on the legality and regularity of the expenditure (to be) declared to the EC. Testing is usually performed through systems audits which look into the design and operating effectiveness of controls by re-performing a number of management verifications. In principle and generally speaking, like for any internal control measure, auditors may be willing to re-use management verifications if these operate effectively. If this is not possible, the auditor must obtain assurance by performing more substantive testing which means gathering evidence through on-the-spot audits. In line with internationally accepted auditing standards and CPR Article 77.1, auditors must always perform substantive tests, but the amount of substantive testing (audits of operations) can be reduced if systems (e.g., 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;
- There is evidence of an appropriate risk-based approach for management verifications;
- Adequate management verification checklists are used; and
- Management verifications are properly recorded and documented.

A risk-based approach to management verifications may involve situations where the AA detects irregularities on a payment claim 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 the payment claim sample in subsequent accounting years.

The AA carry out their audits of operations on the basis of a sample selected<sup>16</sup> from all expenditure declared to the Commission in a given accounting year, regardless of (the results of) the management verifications. Consequently, the AA's sample may contain both (1) the expenditure subject to previous management verifications and (2) expenditure which has not (yet) been verified by the MA/IB.

Any irregular expenditure found must be corrected towards the EU budget. As said at the beginning of Section 4 of this paper, errors found by the AA need to be considered for the calculation of the TER/RTER. It is also important to examine whether an error is one-time or systematic. The same is true for errors found by other control or audit bodies and/or by the MA in an on-the-spot verification (and no administrative verification was performed). These errors should also be corrected.

Finally, it is important for the MA and AA to systematically review and discuss errors identified by audits. 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.

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<sup>16</sup> In case of Interreg Programmes the sample is selected by the European Commission (art. 49 of Regulation 1059/2021).

## Annex 1 – EXAMPLES

### 1.1 - Risk typology

Risk or project risks can be defined as **an uncertain event that may or may not occur during a project**. Risks can have a negative effect on progress towards project objectives.

Generally speaking, risks can be usefully classified in two main categories.

**Inherent risks**, often also referred to as **external** risks, are risks, which are due to (external) factors other than a failure of the management and control system of an organization or project. Hence, such risks are likely adverse events beyond the control of the project management. Such risks manifest in various types and forms.

*Examples* of inherent or external risks are regulatory (e.g., complex or lack of legislation or clear rules), environmental, market-related, political instability. Natural and other types of disasters such as storms, floods, earthquakes, vandalism, terrorism, and civil unrest.

**Control risks**, often also referred to as **internal (control)** risks, are risks that errors occur which are not prevented or detected on a timely basis by the management and control (sometimes also called governance) system of an organization or body. These risks are controllable and can be avoided if the right measures are timely taken.

*Examples* and common types of internal (control) risks are a lack of capacity and understanding of employees with regards to accounting and reporting or specific funding rules such as eligibility of expenditure, procurement, State aid or publicity. No or insufficient clarity tasks (management, accounting, reporting) or no proper segregation of duties where this is possible and economical. Lack of experienced and/or qualified project staff. Poor accounting (including cost accounting and cost allocation rules) and reporting systems. Weaknesses in IT systems and IT controls. Absence of transparent internal procedures.

Other types of (internal) risks can be service related, quality related or technology related.

### 1.2 - 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 house.
- Project *size*. Airports, for example, tend to be more complex than other projects due to their planning, spatial, 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, organization, and so on. Larger contracts may mean that more responsibility is transferred to contractors.

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- *Project location.* Projects in busy city centers or in remote areas may have to overcome intense planning, spatial and environmental constraints.
  - *Political / planning considerations.* Highly-sensitive projects, such as nuclear power stations and 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 contracts to undertake the operation and maintenance of a facility, in addition to design and construction, and transfer it back to the client after a specified time period.
  - *Regulatory requirements.* Regulations may vary from one country to another, and are generally becoming stricter, imposing more, and more complex demands of projects.
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### 1.3 – Simplified Cost Options (“SCOs”)

SCOs are not necessarily complex but depending on the situation they can be and may involve a medium or high risks of errors.

**Example:**

A major European manufacturer of aircraft engines receives funding for the development of cleaner aircraft engines under the EU Cleansky programme. Labor costs represent 80% of total expenditure for the multiannual project which runs over several accounting years. The company has an established but complex cost accounting system, which it uses for internal cost accounting purposes. The system calculates average hourly rates including salaries and salary related items (e.g., social security, pension, holiday pay, bonuses and other salary related items) for individuals, teams, units and departments. It uses average rates for several subsequent time periods and these rates are regularly updated. The company submits a payment claim which is for 80% based on SCOs.

The MA considers the first payment as high risk as the cost accounting system used appears to be complex and not very transparent. Moreover, salary cost items may be included which are fully regular and correct as per the company’s accounting policies but which may not be (fully) eligible as per the funding agreement. Consequently, the first administrative verification is a time-consuming exercise as it involves a detailed review of the SCO methodology, the eligibility of the expenditure items and the eligibility of the employees, teams, units who have spent time on the project. The MA concludes that the SCO methodology is sound and acceptable and that the labor costs claimed are fully eligible.

The MA considers the next payment claims as low risk. There is no need to carry out a full review of the SCO methodology. Verification work can focus on a sample of substantive checks of hourly rates and on the eligibility of the employees and their time spent on the project.

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## 1.4 - Tangible and intangible outputs

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**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 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 training, workshops, conferences and publicity campaigns.

Useful output and related documents include for example training records, attendance lists, 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 very difficult to measure as it can be highly technical and at the same time highly intellectual with low or no visible results

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## 1.5 - Project cost breakdown structures and number and type of cost categories

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A **cost breakdown structure** is a breakdown or hierarchical representation of the various costs in a project. When analyzing cost breakdowns, it is important to understand the *key components* of the project cost structure. If the project cost structure is not clear, there may be a medium or high risk that certain groups of expenditure are not eligible or that expenditure items in certain categories or groups of expenditure are not eligible by their nature and/or not correctly calculated. *Key components* are:

*Cost drivers:* items, units, specific works or services, etc.

*Amounts:* numbers of items, amounts of materials, amounts of work time;

*Overhead:* costs that don't bring any direct value but influence project work processes indirectly.

The structuring of a project's costs is directly linked with the project's nature but usually cost data are grouped by *cost types*. Some cost types should inherently be considered as riskier because of their nature, the magnitude of the cost amounts (per item), and the specific (eligibility) rules that apply for these types of costs. Often costs are classified into direct and indirect or fixed and variable.

*Examples:*

It is important to identify costs categories, which include or may include items that have been or should have been procured in accordance with applicable EU or national procurement rules. Such costs can relate to for example construction works, acquisition of assets such as machinery and equipment or to major services (consulting, technical assistance, marketing, publicity). Such cost items are inherently riskier and should have appropriate attention in risk-based management verifications.

Subcontracting or outsourcing costs may also be riskier as specific rules may have to be complied with.

Salaries and labor costs often represent a major part of project costs. These costs require a critical review of the (eligibility) of the various components. There is a risk that certain components are not eligible or that they are not correctly calculated.

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The following *cost types* are commonly used for structuring the components that build up the final cost of a project:

*Construction and acquisition costs.* The way these costs are presented and structured depends on the nature of the project e.g., buildings, roads, railways, airports etc. These costs can include several of the cost types discussed below.

*Assets acquired for the project (Capital costs).* These can include a wide range such as land, buildings, machinery, equipment, office furniture etc.

*Salaries and labor costs,* also called direct costs, are the costs of employees' time spent on rendering services or performing work within a project. They can incur as work time paid at a specific pay rate, or as a fixed cost per item, unit, or service.

*Subcontracting, or outsourcing costs* are sometimes treated as direct costs and sometimes included in cost structures as a separate category. Again, they can be accrued on the basis of work time spent by an outsourcing team and their pay rates, or as a fixed cost for certain products or services.

*Material costs* arise as costs of raw materials, parts and supplies purchased for using in project works or performing them. Sometimes, this cost type also includes insurance, custom clearance and other costs related to purchasing materials and goods.

*Consumables* are products that are used recurrently, i.e., items which "get used up" or discarded. For example, consumable office supplies are such products as paper, pens, file folders, post-it notes, and toner or ink cartridges.

*Logistics* costs are associated with storing and moving purchased materials and include such subcomponents as transportation, storage, distribution, etc.

Other frequently used cost types are *IT costs (hardware, software), training, travel and subsistence, communication, publicity, marketing etc.*

*Overhead* costs cannot be always allocated to a specific cost driver, but they influence project outcomes indirectly by making project activities possible.

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## 1.6 - Number of projects implemented by a beneficiary

A beneficiary may implement several projects with EU funding. Large organizations 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 (the risk of 'double funding') than once (not necessarily on purpose) certainly 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 project and the payment claim concerned. This is not an easy task. The best practice approach is to request the applicant to provide full insight and to disclose a cost allocation (reconciled with the beneficiary's annual accounts) which covers an overview of all costs incurred and allocated to all relevant activities or projects.

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### 1.7 - Multi-partner projects

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Multi-partner projects often involve team members from several organizations (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 and sometimes many 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.

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### 1.8 - Minimum sample size/coverage

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

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### 1.9 - Random sample

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A random sample may be taken from a long list of staff costs containing bonuses all of which have the same risk profile.

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### 1.10 - Planning of on-the-spot verifications

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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 claim 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 is then updated after 4 months with the next phase, covering the next “batch” of payment claims.

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