



COMMISSION OF THE EUROPEAN COMMUNITIES

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Guidelines
on the principles, criteria and indicative scales to be applied by Commission
departments in determining financial corrections under Article 39(3) of
Regulation (EC) No 1260/1999

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1. PRINCIPLES

The purpose of financial corrections is to restore a situation where 100% of the expenditure declared for cofinancing from the Structural Funds is in line with the applicable national and EU rules and regulations. This allows the establishment of a number of key principles for the Commission services to apply in determining financial corrections :

- (a) Irregularity is defined in Article 1(2) of Regulation 2988/95. Irregularities can be one-off or systemic.
- (b) A systemic irregularity is a recurrent error due to serious failings in management and control systems designed to ensure correct accounting and compliance with rules and regulations.
 - ❑ If the applicable rules and regulations are respected, and all reasonable measures are taken to prevent, detect and correct fraud and irregularity, no financial corrections will be required.
 - ❑ If the applicable rules and regulations are respected, but the management and control systems need to be improved, there should be pertinent recommendations, but no financial corrections need be envisaged.
 - ❑ Where only errors relating to sums of less than €4 000 (the threshold for reporting irregularities under Regulation (EC) No 1681/94) are found, the Member State should be urged to correct the errors without the opening of financial correction proceedings under Article 39(2).
 - ❑ If there are serious failings in the management or control systems which could lead to systemic irregularities, in particular failures to respect the applicable rules and regulations, financial corrections should always be made.
- (c) The amount of the financial correction will be assessed wherever possible on the basis of individual files and be equal to the amount of expenditure wrongly charged to the Funds in the cases concerned. Specifically quantified corrections on each individual operation concerned are not always possible or practicable, however, or it may be disproportionate to cancel the entire expenditure in question. In such cases, the Commission has to determine corrections on the basis of extrapolation or at flat rates.
- (d) Where there is evidence that individual quantifiable irregularities of the same type have occurred in a great number of other operations, or throughout a measure, priority/subprogramme or programme, but it is not cost-effective to determine the irregular expenditure for each operation individually, the financial correction may be based on extrapolation.
 - ❑ Extrapolation can only be used where a homogeneous population or subset of operations sharing similar characteristics can be identified and

shown to have been affected by the deficiency. In this case, the results of a thorough examination of a representative sample of the individual files concerned selected at random are extrapolated to all the files making up the population identified, in accordance with generally accepted auditing standards.

- (e) In the case of individual breaches or systemic irregularities whose financial impact is not precisely quantifiable because it is subject to too many variables or is diffuse in its effects, such as those resulting from a failure to undertake checks effectively to prevent or detect the irregularity or to comply with a condition of the assistance or a Community rule, where it would nevertheless be disproportionate to refuse all the assistance concerned, flat rates should be applied.
 - Flat rate corrections are determined in accordance with the seriousness of the deficiency in the management and control system or the individual breach and the financial implications of the irregularity. A list of what the Commission considers to be key and ancillary elements of systems for the purpose of assessing the seriousness of deficiencies is given in section 2.2. and an indicative scale of flat rates for corrections in section 2.3. Flat rate corrections are applied to all expenditure under the measure or measures concerned unless the deficiencies were limited to certain areas of expenditure (individual operations or types of operation), in which case they are applied to those areas of expenditure only. The same expenditure will not normally be subject to more than one correction.
- (f) In areas where there is a margin for discretion in evaluating the gravity of the infringement, as in cases of disregard of environmental conditions, corrections shall be subject to the following conditions : a significant failure to respect the rules and a clearly identifiable link with the action receiving EU cofinance.
- (g) Irrespective of the kind of corrections proposed by the Commission, the Member State is always given the opportunity to demonstrate that the real loss or risk to the Funds and the extent or gravity of the irregularity was less than that assessed by the Commission services. The Court of Justice has held that the burden of such proof is on the Member State.¹ The procedure and time limits are set out in Article 5 of Regulation (EC) No 448/2001.
- (h) Unlike the case with corrections made by the Member State under Article 39(1), financial corrections decided by the Commission under Article 39(3) always involve a net reduction to the EU funding committed to the assistance.
- (i) Where the Member State's audit system - Court of Auditors, internal or external audits – has detected the irregularities and the Member State takes appropriate corrective action under Article 39(1) of Regulation (EC) No 1260/1999 within a reasonable period of time and observes the provisions of Article 3 of Commission Regulation (EC) No 1681/94, no financial corrections can be imposed by the Commission under Article 39(3) of Regulation 1260/1999 and the Member State

¹ See judgment of ECJ of 21.1.1999 in Case C-54/95, Germany v. Commission, para. 35, referring also to Netherlands v. Commission, Case C-48/93.

is free to reuse the funds. In other cases the Commission may act on the findings of national audit bodies, as it can where an EU audit body establishes the irregularity. When the Commission bases its position on the facts established and fully documented by other EU audit bodies, it will form its own conclusions regarding their financial consequences, after examining any replies from the Member State.

- (j) In all cases of corrections by extrapolation or on a flat-rate basis, the proposed correction is submitted to an ad hoc inter-service advisory panel, which will consider the arguments presented by the Commission auditor for applying the correction and assess whether the level is appropriate.

2. CRITERIA AND SCALES FOR FLAT-RATE CORRECTIONS

2.1 Criteria

As noted in para. 1(c) above, flat-rate corrections may be envisaged when the information resulting from the enquiry does not permit the financial impact of an individual case or several cases of irregularities to be evaluated precisely by statistical means, or by reference to other verifiable data, but does lead to the conclusion that the Member State has failed to carry out adequate verification of the eligibility of claims paid.

Flat-rate corrections should be considered when the Commission finds a failure to adequately effect any control which is explicitly required by a regulation, or implicitly required in order to respect an explicit rule (the limiting of aid to a certain type of operations, for example), and whose absence could lead to systemic irregularity. They should also be considered where the Commission finds serious deficiencies in management and control systems resulting in breaches of applicable rules and regulations on a wide scale or detects individual breaches. Flat-rate corrections can also be appropriate when the Member States' own control services discover such irregularities but the Member State fails to take appropriate corrective action within a reasonable period of time.

In determining whether a flat-rate financial correction should result and, if so, at what rate, the general consideration shall be the assessment of the degree of risk of loss to which Community funds were exposed as a consequence of the control deficiency. Thus the correction should be in compliance with the principle of proportionality. The specific elements to be taken into account should include the following:

- (1) whether the irregularity is related to an individual case, multiple cases or all cases;
- (2) whether the deficiency relates to the effectiveness of the management and control system generally, to the effectiveness of a particular element of the system, i.e. the operation of particular functions necessary to ensure the legality, regularity and eligibility of expenditure declared for cofinancing

from the Funds under the applicable national and EU rules (see section 2.2. below);

- (3) the importance of the deficiency within the totality of the administrative, physical and other controls foreseen;
- (4) the vulnerability to fraud of the measures, having regard particularly to the economic incentive.

2.2. Classification of elements of management and control systems for the purpose of applying flat rates of financial corrections for system deficiencies or individual breaches

Management and control systems for the Structural Funds consist of various elements or functions of greater or lesser importance for ensuring the legality, regularity and eligibility of expenditure declared for cofinancing. For the purpose of assessing flat rate corrections for deficiencies in such systems or individual cases of irregularity, it is useful to classify the functions of management and control systems into key and ancillary elements.

Key elements are those designed and essential to ensure the legality and regularity and indeed the substance of operations supported by the Funds, ancillary elements those that contribute to the quality of a management and control system and help ensure that the system keeps performing well in relation to its key functions.

The list below contains the majority of elements of good management and control systems and good audit practice. The seriousness of deficiencies and individual breaches varies considerably, and cases will therefore be assessed by the inter-service panel having regard, in particular, to section 2.4 below.

2.2.1 Key elements for ensuring eligibility for cofinancing

1. Provision and application of procedures for grant applications, appraisal of applications, selection for funding and selection of contractors/suppliers.
 - a) proper advertisement of calls for applications in accordance with programme procedures
 - compliance, where applicable, with rules on publicity, equality of opportunity and public procurement, and with Treaty rules and principles of transparency, equality of treatment and non-discrimination where EC public procurement directives are not applicable;
 - b) appraisal of project applications in accordance with programme criteria and procedures, including compliance with rules on environmental impact assessment, equality of opportunity legislation and policies;
 - c) selection for funding :
 - applications selected correspond to objectives and published criteria of programme;
 - reasons for acceptance or rejection of applications are clearly set out;

- observance of state aid rules;
 - observance of eligibility rules;
 - inclusion of terms and conditions of funding in approval decision;
- d) selection of contractors/suppliers in accordance with public procurement rules;
2. Adequate verification of delivery of products and services and of eligibility of expenditure charged to programme
- on the part of the managing authority and intermediate bodies lying between the final beneficiary (or the body or firm carrying out the operation) and the managing authority :
 - (a) verifying the reality of “deliverables” (services, works, supplies, etc.) against plans, invoices, acceptance documents, experts’ reports, etc., and, where appropriate, on the spot;
 - (b) verification of observance of conditions of grant approval;
 - (c) verification of eligibility of amounts claimed;
 - (d) adequate follow-up of all outstanding questions before acceptance of claim;
 - (e) maintenance of an adequate and reliable accounting system;
 - (f) maintenance of the audit trail at all levels from final beneficiary or body or firm carrying out operation up through the system.
 - on the part of the paying authority :

Taking reasonable measures to obtain assurance that the declarations of expenditure it certifies to the Commission are correct insofar as:

 - (a) expenditure was effected within the eligible period in operations selected for cofinancing for the specific assistance in accordance with normal procedures and all applicable terms and conditions;
 - (b) under measures for which all state aid has been formally approved by the Commission;
 - (c) the cofinanced operations have actually been carried out.
3. Sufficient quantity and quality of sample checks on operations and adequate follow-up
- a) carrying out sample checks on at least 5% of total eligible expenditure in accordance with the management and control systems regulation, supported by a report on the work done by the auditor;
 - b) the sample is representative and the risk analysis adequate;
 - c) adequate separation of functions vis-à-vis line management to ensure independence;
 - d) follow-up to checks, ensuring
 - (a) appropriate assessment of results and financial corrections where appropriate,

(b) action at a general level to correct systemic irregularities.

e) adequate examination underlying declaration on closure under Articles 15-17 and Annex III of Regulation (EC) No 438/2001.

2.2.2 Ancillary elements

- a) satisfactory administrative controls in the form of standard checklists or equivalent means and proper documentation of results, to ensure for instance :
 - that claims have not been paid before and transactions (contracts, receipts, invoices, payments) are separately identifiable;
 - reconciliation within the accounting system of declarations and expenditure recorded;
- b) proper supervision of payment processing and authorisation procedures;
- c) satisfactory procedures to ensure proper dissemination of information about EU rules;
- d) ensuring timely payment of Community funding to beneficiaries.

2.3 Indicative scales of flat-rate corrections

100% correction

The rate of correction may be fixed at 100% when the deficiencies in the Member State's management and control system are, or an individual breach is, so serious as to constitute a complete failure to comply with Community rules, so rendering all the payments irregular.

25% correction

When a Member State's application of its management and control system is gravely deficient, and there is evidence of widespread irregularity, and negligence in countering irregular or fraudulent practices, a correction of 25% is justified, as it can then reasonably be assumed that the freedom to submit irregular claims with impunity will occasion exceptionally high losses to the Fund. A correction at this rate is also appropriate for irregularities in an individual case which are serious but do not invalidate the whole operation.

10% correction

When one or more key elements of the system do not function or function so poorly or so infrequently that they are completely ineffective in determining the eligibility of the claim or preventing irregularity, a correction of 10% is justified, as it can reasonably be concluded that there was a high risk of widespread loss to the Fund. This rate of correction is also appropriate for individual irregularities of moderate seriousness in relation to key elements of the system.

5% correction

When all the key elements of the system function, but not with the consistency, frequency, or depth required by the regulations, then a correction of 5% is justified, as it can reasonably be concluded that they do not provide a sufficient level of assurance of the regularity of claims, and that the risk to the Funds was significant. A 5% correction can also be appropriate for less serious irregularities in individual operations in relation to key elements.

The fact that the way in which a system operates is perfectible is not in itself sufficient grounds for a financial correction. There must be a serious deficiency of compliance with explicit Community rules or standards of good practice and the deficiency must expose the Structural Funds to a real risk of loss or irregularity.

2% correction

When performance is adequate in relation to the key elements of the system, but there is a complete failure to operate one or more ancillary elements, a correction of 2% is justified in view of the lower risk of loss to the Fund, and the lesser seriousness of the infringement.

A 2% correction will be increased to 5% if the same deficiency is established in relation to expenditure after the date of the first correction imposed and the Member State has failed to take adequate corrective measures for the part of the system at fault after the first correction.

A correction of 2% is also justified where the Commission has informed the Member State, without imposing any correction, of the need to make improvements to ancillary elements of the system that are in place but do not operate satisfactorily, but the Member State has not taken the necessary action.

Corrections are only imposed for deficiencies in ancillary elements of management and control systems where no deficiencies have been identified in key elements. If there are deficiencies in relation to ancillary elements as well as in key elements, corrections are only made at the rate applicable to the key elements.

2.4 Borderline cases

Where the correction resulting from a strict application of these guidelines would be clearly disproportionate, a lower rate of correction may be proposed. The inter-service advisory panel referred to in para. 1 j) will give careful consideration to the proportionality of corrections.

For example, where the deficiencies arose from difficulties in the interpretation of Community rules or requirements (except in cases where it should reasonably be expected that the Member State raise such difficulties with the Commission), and the national authorities took effective steps to remedy the deficiencies as soon as they were brought to light, this mitigating factor may be taken into account and a lower rate or no correction may be proposed. Similarly, due regard should be paid to claims of legal security

when the deficiencies were not reported following earlier audits by the Commission's services, or, in the case of Community initiatives implemented in the form of global grants, where the procedures have been agreed between the Commission and the Member State in accordance with Article 27(2) of Regulation (EC) No 1260/1999.

In general, the fact that deficient management or control systems were improved immediately after the deficiencies were reported to the Member State is not considered as a mitigating factor when assessing the financial impact of the systemic irregularities before the improvement was made.

2.5 Basis of assessment

Whenever the situation in other Member States is known, there should be a comparison between them to ensure equal treatment in the assessment of the rates of correction. This is a prime objective of the inter-service advisory panel.

The rate of correction should be applied to that part of the expenditure placed at risk. When the deficiency results from a failure by the Member State to adopt an appropriate control system, then the correction should be applied to the entire expenditure for which that control system was required. When there is reason to suppose that the deficiency is limited to that of a particular authority's or region's application of the control system adopted by the Member State, the correction should be limited to the expenditure controlled by that authority or region. When the deficiency relates for example to verification of the criteria for eligibility for a higher rate of aid, then the correction should be based on the difference between the higher and lower rate of aid.

The correction should normally concern the expenditure of the measure over the period being examined, for example one financial year. However, when the irregularity results from systemic deficiencies, which are evidently long-standing and affecting several years' expenditure, then the correction should concern all the expenditure declared by the Member State while the system deficiency obtained until the month in which it was remedied.

When several deficiencies are found in the same system, the flat rates of correction are not cumulated, the most serious deficiency being taken as an indication of the risks presented by the control system as a whole². They are applied to the expenditure remaining after deduction of the amounts refused for individual files. In the case of the Member State's non-application of sanctions prescribed by national law, the financial correction should be the amount of the sanctions not applied, together with 2% of the remaining claims, as the non-application of sanctions increases the risk that irregular claims will be submitted.

² See also section 2.3 (2% correction).

3. APPLICATION AND EFFECT OF NET FINANCIAL CORRECTIONS

Where the Member State agrees to make the financial correction proposed in the procedure under Article 39(2) of Regulation 1260/1999, the Commission need not impose a net reduction in the funding to the programme but allow the Member State to reprogramme the sums released. However, financial corrections imposed by Commission decision under Article 39(3) after completion of the procedure laid down by Article 39(2) will in all cases involve a net reduction in the Member State's indicative allocation of funding under Article 7(3) of the Regulation.

A net correction should in any case be applied where the Commission judges that the Member State has failed to give a sufficient follow-up to the findings of irregularities detected by national or Community bodies, and/or if the irregularity is attributable to a serious failing in the management or control systems of the Member State, or the managing or paying authority.

Interest on any sums to be reimbursed to the Commission following net corrections should be charged under Article 39(4) of Regulation 1260/1999 in accordance with Article 7 of Regulation (EC) N 448/2001.