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COVER NOTE

from:	Mr Vítor CALDEIRA, President of the Court of Auditors
date of receipt:	26 December 2012
to:	Mr Radoslaw SIKORSKI, President of the Council of the European Union
Subject:	Opinion 7/2011 on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006

Sir,

I enclose a copy of opinion No. 7/2011 on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006.

The special report, which is shortly to be published, was adopted by the Court at its meeting on 15 December 2011.

(Complimentary close).

(s.) Vítor CALDEIRA

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Encl.: Opinion No. 7/2011 on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006[1]

[1] In English only. The other languages of this opinion are available on the European Court of Auditor's website: http://eca.europa.eu/.

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EUROPEAN COURT OF AUDITORS
COUR DES COMPTES EUROPÉENNE
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Opinion 7/2011

on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006

(presented pursuant to the second subparagraph of Article 287(4) of the Treaty on the Functioning of the European Union)

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Detailed comments to the Commission's proposal

THE COURT OF AUDITORS OF THE EUROPEAN UNION,

Having regard to the Treaty on European Union, and in particular Articles 4 and 5, and the Treaty on the Functioning of the European Union (TFEU), in particular Articles 174 to 178, 287(4), second subparagraph, 317, 318 and 322 thereof;

Having regard to Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities[2] and to its implementing rules[3];

Having regard to the Council's request for an opinion, which reached the Court on 11 November 2011;

Having regard to the proposal for a general Regulation presented by the Commission[4] as well as its Funds-specific proposals[5];

Having regard to the impact assessment on the proposed regulatory package revising the Regulations applicable to the management of the Structural and Cohesion Funds[6];

Having regard to the Commission communications entitled 'Conclusions of the fifth report on economic, social and territorial cohesion: the future of cohesion policy'[7], 'The EU Budget review'[8] and 'A Budget for Europe 2020'[9];

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2 OJ L 248, 16.9.2002, p. 1.

3 Commission Regulation (EC, Euratom) No 2342/2002 (OJ L 357, 31.12.2002, p. 1).

4 European Commission, COM(2011) 615.

5 European Commission, COM(2011) 612 (Cohesion Fund); COM(2011) 614 (ERDF); COM(2011) 607 (ESF); COM(2011) 610 (EGTC); COM(2011) 611 (ETC); COM(2011) 627 (EAFRD); COM(2011) 804 (EMFF).

6 European Commission, SEC(2011) 1141.

7 European Commission, COM(2010) 642.

Having regard to its Annual and Special reports as well as to the Court's Opinion No 2/2004 on the 'single audit' model[10], the response by the European Court of Auditors to the Commission's communication 'Reforming the Budget, Changing Europe'[11], the Court's Opinion No 1/2010 'Improving the financial management of the European Union budget: Risks and challenges'[12] and the Court's Opinion No 6/2010 on a proposal amending the Financial Regulation[13];

Whereas, pursuant to Article 5 of the Treaty on European Union, the Union takes action in areas which do not fall within its exclusive competence only if and insofar as the objectives of the proposed action, by reason of the scale or effects, can be better achieved at Union level;

Whereas following Article 174 of the Treaty on the functioning of the European Union, in order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion;

Whereas Article 317 of the Treaty on the functioning of the European Union makes the Commission responsible for the implementation of the budget, having regard to the principle of sound financial management, and requires the Member States to cooperate with the Commission to ensure that the appropriations are used in accordance with this principle,

HAS ADOPTED THE FOLLOWING OPINION:

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[8] European Commission, COM(2010) 700.

[9] European Commission, COM(2011) 500.

[10] OJ C 107, 30.4.2004.

[11] Published in April 2008.

[12] http://eca.europa.eu

[13] OJ C 334, 10.12.2010.

INTRODUCTION

1. The European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF) (hereinafter referred to as the 'CSF[14] Funds') pursue complementary policy objectives and their management is shared between the Member States and the Commission. 'CSF Funds' could represent up to 45 % of the total expenditure for the 2014-20 period whose leading theme is the Europe 2020 strategy [15]. The contribution of the EU Budget to meeting the Europe 2020 objectives depends therefore to a large extent on an economical, efficient and effective use of CSF funds. This will also impact on the credibility and legitimacy of the EU action.

2. The Court opinion so far as possible follows the structure of the Commission's explanatory memorandum regarding the content of the general Regulation. It consists of two parts, the first deals with general observations and the second contains a detailed analysis of the draft general Regulation.

PART I

General observations

3. The aim of the Commission's proposal for a general Regulation is to deliver a common set of basic rules geared towards a focus on results through a simplification of policy delivery and an increased use of conditionality. The proposal addresses also Member States' capacities to absorb large volumes of EU funds and the need to strengthen their administrative and institutional capabilities. The proposed reduction of the capping rate for national allocations

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[14] Common Strategic Framework, the CSF Funds refer to the Funds covered by the Common Strategic Framework.

[15] European Commission, COM(2011) 500.

is a significant policy change, whose impact needs to be assessed by the Commission.

4. Overall, the proposal essentially retains the framework that was established in the previous programming periods, although a further emphasis is placed on Member States' responsibilities, in particular concerning systems set-up and financial management. The respective roles and responsibilities of the Commission and Member states remain a key theme in the design of Cohesion spending instruments. The ongoing challenge for the Union is to obtain good qualitative results from a scheme where funds are pre-allocated among Member States and absorption is an implicit objective. An effective supervision and accountability from the Commission on the use of the funds will support Member States' capacity to use these funds successfully.

5. The arrangements for Cohesion spending are complex. There are six layers of rules (common provisions, general provisions, Fund-specific provisions, delegated acts, implementing acts, Commission's guidelines). National legislation will, in some cases, constitute an additional layer. The Court notes the positive efforts to reduce beneficiaries' administrative burden (for example, through the increased use of lump sums and standard costs). However, the burden for the EU and national administrations remains high, and will even possibly become higher than is currently the case.

6. Despite the claimed focus on results, the scheme remains fundamentally input-based, and therefore oriented towards compliance rather than performance. The latter objective is essentially left to the introduction of a performance reserve (whose success will depend on the capacity to develop suitable indicators) and of Joint Action Plans with specific objectives, result indicators and outputs as a basis for payments (with the expectation that the current input based management structure will not be needed anymore). The provision for *ex ante* conditionalities should permit addressing the lack of coordination among different EU policies noted in the past.

7. The Court also notes the distinction between 'common' provisions (applicable to all CSF Funds) and 'general' provisions (applicable only to some of them: ERDF, ESF and CF). This leads to an incoherent legislative framework and the question is whether it would be preferable to limit the general Regulation to those provisions which are applicable to all five Funds (the 'common provisions') and to include other provisions ('general provisions') in Fund-specific regulations.

8. Finally, the Court would like to point out that on several aspects the regulatory requirements are deferred to a later stage, through delegated and implementing acts under Articles 290 and 291 TFEU. Prior adequate consultation with all stakeholders concerned will therefore be key in ensuring that those acts comply fully with the objectives laid down by the general Regulation. The Court notes in particular that matters to be covered by delegated acts, meant to cover non-essential elements of EU legislation, deal in reality with key elements of the future Cohesion scheme[16]. Concerning the conferral on the Commission of implementing powers[17], the Court observes that in several cases the procedure (advisory or examination) for adoption of these acts following the Regulation (EU) No 182/2011 is not specified. As a result, the respective roles of the Commission and of the Member States remain undefined (for example, in case of suspension of payments and financial corrections, see Articles 134(2) and 137(5) of the general Regulation).

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[16] Such as the adoption of a Common Strategic Framework; the adoption of detailed rules on financial instruments; the responsibilities of Member States concerning the procedure for reporting irregularities and recovery of sums unduly paid; the conditions of national audits; the accreditation criteria for managing authorities and certifying authorities; the level of financial correction to be applied; the amendment of the method for establishing the performance framework and the set of *ex ante* conditionalities.

[17] Such as decisions approving the Partnership Contracts, decisions allocating the performance reserve and decisions suspending payments linked to Member States' economic policies; and as regards the Funds, decisions adopting operational programmes, decisions approving major projects, decisions suspending payments and decisions on financial corrections.

Strategic issues

EU added value

9. The Court has highlighted that expenditure programmes which do not add European value are by definition unlikely to be an effective and efficient use of the EU taxpayer's money[18]. It has therefore recommended articulating the concept of European added value in a suitable political declaration or in EU legislation in order to provide guidance to the EU's political authorities to be used when choosing expenditure priorities[19]. A favourable opportunity for the Legislative authorities is to do so when putting in place the legal framework for the 2014-20 period.

10. A fundamental pre-requisite of EU spending added value is that it must offer clear and visible benefits for the EU and for its citizens which could not be achieved by spending only at national, regional or local level[20]. In that perspective, the Court has suggested recasting expenditure programmes in terms of acceptable outputs; with programmes based on a set of concrete objectives, and disbursements linked to the achievement of results[21]. The Commission endorsed this stance in its proposal for amendment of the Financial Regulation[22] and indicates in the explanatory memorandum to the draft general Regulation that focus on results will be one of the major hallmarks of the next set of programmes[23]. In practice, like the proposal for amendment of the Financial Regulation[24], the proposed future Cohesion scheme falls short of

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[18] European Court of Auditors, Budget review paper, paragraph 7.

[19] European Court of Auditors, Opinion No 1/2010, paragraph 18.

[20] European Court of Auditors, Budget review paper, paragraph 8.

[21] European Court of Auditors, Budget review paper, paragraph 24.

[22] European Commission, COM(2010) 260, point 4.

[23] European Commission, COM(2011) 615, points 1 and 5.2.2.

[24] European Court of Auditors, Opinion No 6/2010, paragraphs II and 42.

this aspiration and remains fundamentally input-based. The claimed switch towards a performance oriented scheme is limited to the introduction of a performance reserve and of Joint Action Plans.

Thematic concentration

11. The Court has suggested that reasonable concentration of expenditure is prima facie likely to support the objective of adding value[25] so as to build up a critical mass and make it more likely that EU interventions will have a tangible impact.

12. The proposal (Article 9 of the draft general Regulation) provides for 11 thematic objectives derived from the Europe 2020 Strategy. Collectively they represent a very wide range of activities in support of which money from CSF funds can be spent. Out of these thematic objectives, the ERDF intervention should focus on three of them[26], in particular for more developed and transition regions. Four 'thematic objectives' are proposed for the ESF[27]. Within these 'thematic objectives', the number of investment priorities for the ESF is limited to four (Article 4(3) of the ESF draft Regulation). However, the ERDF could intervene in each of the 32 investment priorities foreseen (Article 5 of the ERDF draft Regulation). This would make possible to fund almost any kind of projects[28]. Finally, no concentration is deemed necessary for a number of

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[25] European Court of Auditors, Budget review paper, paragraph 8.

[26] Strengthening research, technological development and innovation; Enhancing the competitiveness of small and medium-sized enterprises; Supporting the shift towards a low-carbon economy in all sectors.

[27] Promoting employment and supporting labour mobility; Investing in education, skills and lifelong learning; Promoting social inclusion and combating poverty; Enhancing institutional capacity and an efficient public administration.

[28] Actually only a limited number of categories of projects is formally excluded for ERDF (Article 3 of the ERDF draft Regulation), such as those dealing with the manufacturing, processing and marketing of tobacco and tobacco products or the decommissioning of nuclear power stations; in more developed regions only, investments in infrastructure providing basic services to citizens in the areas of environment, transport, and ICT.

thematic objectives[29] and, as a consequence, it will be even more difficult to achieve the necessary critical mass for those priorities.

13. Finally, whereas for the ERDF, ESF and CF a maximum amount of support is to be defined for each priority axis, for the EAFRD and the EMFF this maximum amount of support is to be established at the level of each measure. No justification is provided for this distinction. At present, the amounts in the EAFRD programmes are allocated to priority axes which makes it possible to fix (and concentrate) budgets per objective rather than per measure.

Common Strategic Framework

14. The provision for a Common Strategic Framework (Article 11 of the draft general Regulation) is meant to translate the objectives and targets of the Union priorities into key actions for CSF funds. The Common Strategic Framework should also identify coordination mechanisms among Cohesion funds and other EU policies and instruments (for example, EIB financial instruments, Research Framework programmes, Connecting Europe Facility and Trans-European Networks, Competitiveness and Innovation Framework Programme). Given the significant part of CSF funds proposed for Research and Innovation, such coordination will be of particular interest in this area. The envisaged coordination would make it possible to set the co-financing rate from the Funds to operational programmes taking account of the different EU funding sources, thereby potentially increasing the multiplier effect of Union resources.

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[29] Enhancing access to, and use and quality of, information and communication technologies; Promoting climate change adaptation, risk prevention and management; Protecting the environment and promoting resource efficiency; Promoting sustainable transport and removing bottlenecks in key network infrastructures.

Partnership contracts

15. With the aim of encouraging results-oriented spending Article 14 of the draft general Regulation provides for the setting of agreed condtionalities and targets. For this the proposal envisages the introduction of a Partnership Contract, an additional layer compared to the current programming period. It is however for consideration whether this extra provision is necessary or if conditionalities and targets could be set instead in the programmes themselves, building upon the implicit 'contract' between the EU and national authorities in the operational programmes which apply in the current programming period.

***Ex ante* conditionalities**

16. The Commission proposes (Article 17 and Annex IV of the draft general Regulation) that a number of *ex ante* conditionalities shall be defined for each Fund. This is a key development which could reinforce the "intervention logic" of EU actions by facilitating the necessary integration of CSF funding with other EU policies and finally have a positive impact on the effectiveness of the investments. Indeed, Court's audits' show[30] that funding projects without taking account of broader EU policy requirements (for example, environment and water resources protection) and outside a comprehensive development plan, setting out long term needs and priorities appropriate to the context, is not the most effective way for using EU funds.

***Ex post* conditionality (mid-term performance review, performance reserve)**

17. For the new period, the Commission also plans to release 5 % of the funds depending on the results obtained (Articles 18, 19 and 20 of the draft general Regulation). A similar performance reserve existed in the 2000-06 with limited success due to the very limited amount of expenditure that had been completed

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[30] See Special Reports No 3/2009 and No 9/2010 (http://eca.europa.eu).

in time for the mid-term review and the lack of an appropriate methodology for assessing progress achieved by programmes. In the 2007-13 period Member States might introduce such a reserve but very few have made use of this possibility.

18. The method for the performance review (detailed in Annex I of the draft general Regulation) shows that this review will still mainly focus on financial implementation (financial indicators), on outputs and only in a limited way on results (outcomes, impacts). In line with the Impact assessment, one should also consider whether it would be feasible to set robust indicators, how factors unrelated to a specific programme could be identified, how results which may only be visible in the long term could be taken into account[31]. The added-value of a performance reserve will be considerably reduced if very low and easy to achieve targets will be set or if performance disbursements will in the end be mainly based on absorption grounds as the Court noted for the period 2000-06. Also, the allocation of a performance reserve should be subject to a sufficient implementation of operational programs [32]. It should therefore be provided that the reference years for the review of performance, currently 2016 and 2018, will be revised in case of delayed start of the programs.

Macro-economic conditionality

19. Among the set of conditionalities proposed, the Commission also suggests (Articles 11 and 21 of the draft general Regulation) establishing a link between Cohesion policy and European economic governance, such as the excessive deficit procedure, excessive imbalances procedure and the European semester of economic policy coordination. The Commission could ask to review programmes or suspend the funding if remedial action is not taken.

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[31] European Commission, SEC(2011) 1141-I, p. 62.

[32] See Special Report No 1/2007 (OJ C 124, 5.6.2007).

20. The application of the envisaged macro-economic conditionality would require careful consideration, since it might entail difficulties for the implementation of CSF programmes, legal uncertainties and a potential risk for the the fulfilment of long term obligations taken in the framework of partnership contracts by the respective partners at national and regional level.

Joint Action Plans

21. In view of simplifying and reinforcing the result orientation of EU funds, the Commission proposes the introduction of Joint Action Plans (Article 93 of the draft general Regulation) for ERDF, ESF and CF. These consist of a group of projects as part of an operational programme, where EU funds are directly linked to the respect of specific objectives and outputs, agreed milestones, result indicators. Such an instrument could represent an alternative intervention mechanism geared towards performance as long as it replaces rather than complements the current input based management structure.

Common management and control arrangements

Institutional capacity

22. Adequate institutional capacity is necessary to ensure that EU funds are correctly spent to support durable economic development. Effectiveness of national management and control systems should therefore be ensured from the start. Regulation alone is however not enough[33]. Key in this respect will be the day-to-day actions of managers in the Commission and in the Member States on whose systems assurance at EU level heavily relies. For example, the Commission's analysis of errors in Cohesion policy for the years 2006-09 points to weaknesses in the administrative capacity and the national management and control systems as the main factor explaining those errors[34].

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[33] European Court of Auditors, Opinion No 6/2010, paragraph I.

[34] European Commission, SEC(2011) 1179.

23. The Court notes that one of the thematic objectives put forward by the draft general Regulation is 'Enhancing institutional capacity and an efficient public administration'. This constitutes rather a pre-requisite for achieving the other 10 thematic objectives than an objective itself. It is also noted that the support for administrative capacity is limited for the ESF to Member States with less developed regions or eligible to the Cohesion Fund; this is not the case for ERDF although national systems for the two Funds are subject to similar requirements.

National accreditation

24. With the introduction of an accreditation procedure, the draft Regulation reinforces Member States' responsibilities concerning the administrative capacity of national management and control bodies (recitals 42 to 44 and Article 64 of the draft general Regulation). The intention is to submit to an accreditation process all bodies responsible for the management and control of CSF funds (Article 64(1) of the draft general Regulation). Thus, national authorities would accredit management authorities and, where appropriate, certifying authorities for the implementation of ERDF, ESF, CF.

25. The Court is of the opinion that the Commission, as holder of the ultimate responsibility in the budget implementation, should have a supervision role in this process to mitigate the risk of leaving the detection of any failure to subsequent checks, which may lead to more frequent checks, action plans requirements and financial corrections[35]. Such a role should imply for the Commission to confirm, for example in the Directors-general Annual Activity reports, that management and control bodies satisfy the conditions for a

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[35] This is particularly the case for procurement procedures, a key pre-condition for the implementation of the internal market. As indicated by the Commission (COM(2011) 615, p. 167), infringements in this area alone lead to an error rate on payments of approximately 2 %-4 % on average each year for the current programming period. If public administrations and beneficiaries in the Member States are unable to improve the implementation of the procurement rules, Cohesion Policy would continue to be systematically affected.

national accreditation as provided for in the relevant delegated act. This would require, at the start of the programmes, to assess the documentary evidence provided by the Member States and subsequently to review the functioning of the systems, for example on a risk basis in line with the suggestion made in the explanatory memorandum[36].

26. In addition, the draft Regulation foresees that Audit authorities, who provide an opinion on the CSF annual accounts submitted to the Commission, are designated by Member States. The Court considers that since the Commission is using the work of these bodies as a source of assurance, it should review (by systematic on-the-spot visits) their systems and their performance in order to ensure that their work is reliable[37].The Court also points out that the role of annual accounts and of their audit is not clear in the Commission's proposal. Extensive accounting information is to be provided at the mid-point of the financial year (at present not required for Commission's accounts) but there is no clear requirement for reliable information at year end (information that is required for Commission's accounts). The Commission proposal therefore requires significant clarification.

Management declaration of assurance

27. In order to strengthen the arrangements in the area of assurance and financial management, the Commission proposes to introduce the management declaration of assurance to be drawn up by the Managing Authorities of the operational programmes (Article 114(4)(e) of the draft general Regulation). This declaration shall cover the functioning of the management and control systems,

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[36] European Commission, COM(2011) 615, paragraph 5.2.3.

[37] European Court of Auditors, 2006 Annual Report, paragraphs 5.45, 5.77; Special Report No 7/2010 (http://eca.europa.eu), paragraph 104(a).

the legality and regularity of the underlying transactions and the respect of the principle of sound financial management[38].

28. As stated by the Court, whether these declarations provide useful information to the Commission for assurance purposes will depend on the scope and quality of the work that underlies them[39]. This should be clarified in the implementing act adopting the model for the management declaration. In this respect the Court draws attention to the weaknesses found in the agriculture area[40] (insufficient basis for paying agencies' statement of assurance, limited added value of the certification bodies' opinion) which, if unresolved, will limit the assurance the Commission can take from these declarations.

29. The Court also notes that the extent to which this declaration may meaningfully cover the sound financial management of Cohesion spending will depend on a shift from the current focus on processes and financial implementation towards a performance-based system, with criteria against which performance is to be measured. In this respect, as noted earlier (see paragraph 6), the Cohesion scheme remains fundamentally input-based and while the managing authority has in principle a day-to-day responsibility for ensuring the sound financial management, the description of its tasks basically relates to compliance requirements only[41].

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[38] The use of the expression 'declaration of assurance' risks creating confusion. The description of the roles of management and the auditor needs to ensure that their tasks are clear and accord with best practice.

[39] European Court of Auditors, Opinion No 6/2007 (OJ C 216, 14.9.2007), paragraph V.

[40] European Court of Auditors, Special Report No 7/2010 'Audit of the clearance of accounts procedure', paragraphs 39 to 52.

[41] Moreover, when looking at the functions of the certifying and audit authorities (Article 115 and 116 of the general Regulation) there is no mention of the principle of sound financial management.

Clearance of accounts, 'rolling' closure and financial corrections

30. The Commission proposes to introduce an annual clearance of accounts procedure and an annual 'rolling' closure of completed operations or expenditure (Articles 130 and 131 of the draft general Regulation).

31. The Court notes that the 'clearance decision' (Article 76 of the proposal) shall cover 'the completeness, accuracy and veracity of the financial accounts submitted and shall be without prejudice to any subsequent financial correction'. As the annual clearance decision would not cover the legality and regularity of the underlying transactions, the same problems noted by the Court for agriculture expenditure[42] will be extended to all CSF funds. The Court recommends bringing Article 76 in line with the provisions of the Financial Regulation. Also, as stated already in its Special Report No 7/2010, the Court recommends establishing time limits for all stages of the procedure and, in particular, a time limit for the Commission to take its final decision on a specific financial year.

32. According to the Financial Regulation (Article 53b(4)) and its implementing rules (Article 42), the aim of the clearance of accounts is to establish the amount of expenditure recognised as chargeable to the budget after the Commission has performed appropriate checks. In the proposal of general Regulation, the Commission's checks would only take place after the clearance and therefore this process would not take into account subsequent financial corrections.

33. With the rolling closure, the Commission seeks to provide legal certainty to the individual beneficiaries about the eligible expenditure for a given year and to reduce the burden associated with a long retention period of documents. Like for the clearance of accounts, the rolling closure is subject to further checks and cannot therefore represent a final closure of operations. However,

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[42] See Special Report No 7/2010.

the rolling closure may potentially bring some benefits for the Cohesion area as national checksand audits will have to take place at an earlier stage, hence permitting better preventive control arrangements. The fact that any irregularity detected subsequent to the presentation of the annual accounts will lead automatically to a net financial correction (Article 137(6) of the draft general Regulation) is the consequence of the increased Member States' responsibilities and reliance on their reimbursement claims.

34. As discussed above, the Cohesion scheme is set out as a multi-annual process. Full compliance of expenditure is not sought by the Commission annually but several years later and ultimately at the stage of the closure of operational programmes. Financial corrections mechanisms are the key instrument for this purpose. They are to be applied first and foremost by Member States themselves. When the latter fail to correct irregularities, the Commission may on its turn impose financial corrections on the Member States.

35. Recent Court audits confirm what was noted previously[43]. Despite a lengthy administrative process, there is no assurance that financial corrections mechanisms compensate in an adequate manner the errors uncovered, and that all material issues are resolved at the closure of the operational programmes. There is equally no evidence that financial corrections mechanisms translate into lasting systems' improvements as to avoid errors uncovered to occur again. One of the reasons is their limited financial impact (thus a limited incentive on Member States to improve systems' performance) since most of the 'irregular' expenditure is substituted by a buffer of national spending. However, this does not make the underlying transactions any less illegal/irregular and their effect is to shift the cost of the (disallowed) illegal/irregular transactions from the EU budget to national budgets. In the end, final recipients may feel no effect whatsoever.

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[43] See 2005 Annual Report, paragraphs 1.65, 6.33 to 6.37; 2010 Annual Report, paragraph 1.25.

36. The effectiveness of these mechanisms depends on the incentive they provide to recover irregular payments from final recipients and to bring about improvements in the supervisory and control systems. For errors detected in individual transactions where the final recipient is at fault, the initiation of recovery proceedings is expected.[44] The Commission should therefore clear irregularities only when the Member State has at least initiated such a procedure.

37. There is finally a need to assess the realism of the intention to apply financial corrections where the shortfall in the achievement of milestones or targets is significant (recital 18, Article 20(4)). The Commission may not be able to assess the reliability of the data provided by Member States and may not dispose of independent information sources (see paragraph 39). It also remains to define what a 'significant' shortfall in the achievement of milestones or targets is.

Monitoring and evaluation

38. According to the draft general Regulation (Article 24), each funded programme shall define priorities setting out specific objectives. Each priority shall set out indicators to assess progress of programme implementation towards achievement of objectives as the basis for monitoring, evaluation and review of performance (financial indicators relating to expenditure allocated; output indicators relating to the operations supported; result indicators relating to the priority). These indicators will include mainly outputs but also some intermediate results. For each priority axis, managing authorities shall carry out at least one evaluation on the effects and effectiveness of interventions during the programming period.

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[44] Member states have an obligation of recovering undue payments (see Article 4 of Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests (OJ L 312, 23.12.1995, p. 1) and Article 53b(2)(c) of the Financial Regulation).

39. As a result, the draft general Regulation requires the Member States to produce a significant amount of data for monitoring and evaluating the programmes (Articles 41 to 50 of the draft general Regulation). Courts' audits[45] have shown serious deficiencies in relation to the relevance and reliability of the information presented by the Member States to the Commission. Therefore, the aim of making EU funds conditional upon results would require significant improvements as these data could trigger the EU disbursements and should as a result be subject to verification and control procedures. The more so as in accordance with the Treaty (Article 318 TFEU) the Commission has the obligation to establish annually an evaluation report on the Union's finances based on the results achieved. The Commission should therefore consider how far is possible to ensure that the data produced by the Member States in relation to the monitoring, evaluation and performance of programmes have an acceptable quality level in terms of relevance, comparability and reliability.

Simplified and streamlined eligibility rules

40. The draft general Regulation provides for the harmonisation of eligibility rules with other EU financial support instruments. At the same time, the general principle introduced in the current 2007-13 period by which eligibility rules are specified at national level (and possibly for each operational programme) is maintained (see recital 39). Experience suggests that these two principles may sometimes conflict.

41. The Court also notes that the use of simplified cost options is to be continued. This is appropriate since it may help in some cases to reduce the administrative burden for beneficiaries and as well as the possibilities for errors.

42. The draft general Regulation provides for the use of electronic data management and requires Member States to set up systems by the end of 2014 to enable beneficiaries and final recipients to submit all information by

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45 Special Reports No 5/2010 and No 7/2011(http://eca.europa.eu), 2010 Annual Report, paragraphs 8.15 to 8.29.

way of electronic data exchange. To make this proposal operational a number of technical aspects and specifications will need to be agreed within Member States and regions, but also between the different Commission's Directorates-General and national authorities. Also, the type of non-financial monitoring data that will need to be reported still needs to be determined.

43. The Court also considers useful the provision in the draft general Regulation whereby the functions of the Managing and Certifying Authorities can be merged (Article 113(3)). This may strengthen accountability by assigning responsibility for financial management and control to one authority and reduce the national administrative burden and the control burden of beneficiaries. Retaining the audit authority and its main functions as an independent audit body guarantees in principle the required segregation of responsibilities.

Community-led local development

44. The proposal is to extend the community- led local development approach (LEADER) to all funds, as a method to achieve the EU objectives through a bottom-up, rather than the traditional top-down approach. It promises an added value from a collaborative and strategic approach, local decision making and innovative measures. The Court notes that that such an approach entails additional costs and additional risks (for compliance as well as sound financial management) which result from giving control of the EU budget to local action groups (LAGs).

45. In its Special Report on the LEADER approach[46] the Court observed that, in order to ensure efficiency and effectiveness, the measures or solutions developed by the LAGs should be specific to this approach. The Court found that, on the whole, the additional costs and risks were not sufficiently controlled and that the potential added value was not achieved in practice.

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[46] Special Report No 5/2010.

Financial instruments

46. Financial instruments are a form of intervention which can, in principle, leverage in private funding and ensure the re-use of resources for future recipients. The Commission proposes to encourage and enhance their use in the next programming period as an alternative to non-reimbursable grants.

47. The draft general Regulation provides for ex ante assessment specific to financial instruments and the possibility to have financial instruments set up at Union level, and the increase of the EU co-financing rate up to 100 % at the 'priority axis' level (Articles 32, 33 and 110).

48. The Court notes that financial instruments present risks and problems[47], for example, in the accounting of the use of EU funds, their supervision, the ownership of the financial instruments, the capacity of Commission services to manage relatively complex financial instruments.

49. Recent audit work by the Court cast significant doubt on the suitability of the 2000-06 and the 2007-13 ERDF regulatory framework within which financial instruments have been or are being implemented. In particular, the Court identified the following main weaknesses: the insufficiency of leverage and fund revolving provisions, the possibility to commit excessive allocations to financial instruments, the possibility for unjustified recourse to preferential private sector treatment, the unclear eligibility conditions for working capital. In addition, the scattering effects of using multiple operational programmes within one Member State may lead to the creation of funds without sufficient critical mass which contributes to delays. The current draft general Regulation does not address these weaknesses in a satisfactory way.

50. The Court also draws attention to the risk of enlarging the number of fields in which financial instruments can be implemented without ensuring that

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47 European Court of Auditors, 2010 Annual Report, paragraphs 1.30 to 1.32; 4.30 to 4.36; Opinon No 6/2010, paragraphs 43 to 47.

appropriate monitoring and supervisory control systems are in place. The Parliament and Council might also wish to satisfy themselves whether the draft Regulation limits the support to only relatively conventional forms of financial instruments (equity participations, loans, guarantees), and will not permit support for less transparent financial instruments such as derivative or structured financial instruments.

PART II

Detailed comments to the Commission's proposal

Article	Observation
Recital 41	It would add legal certainty if the draft general Regulation listed the specific provisions on State aid regarding financial instruments.
Recital 87	The Court recommends to change the text as follows '...In order that the level of auditing by the Commission is proportionate to the risk, the Commission should be able to reduce its audit work in relation to operational programmes where there are no significant deficiencies and where the audit authority can be relied on.'
Article 4(5)	It is not clear from the regulation how the principle of proportionality should be applied and how proportionality should be assessed.
Article 4(9)	This provision, limited to effectiveness, is redundant and contradictory with Article 4(8) which refers to Article 73 of the Financial Regulation, and therefore also to the principles of economy and efficiency. In any event, the stages of 'planning' and 'implementing' should be added to monitoring, reporting and evaluation.
Article 8	This article introduces the 'polluter pays' principle in the secondary legislation. However, for example in agriculture, the application of the principle suffers from weaknesses in the supervisory and control systems (lack of relevant controls, reductions of subsidies calculated as a proportion of aid rather than as a proportion of the impact on the environment) as well as in the actual enforcement of the reductions of payments. The Court recommends reinforcing this principle by ensuring its application in the relevant parts of the fund-specific regulations as well as in the programmes of the Member States.
Article 24(3), Article 40(2)(h)	The indicators required will be over and on top of the SMART indicators specific to financial instruments. Given the combination of such indicators with numerous but general OP indicators for grants, there is another argument why financial instruments should preferably be co-financed from one single OP.

Articles 28 to 31	The 'Community-led local development' could be an important mechanism to create and upgrade local institutional capability towards result oriented implementation. While recital 21 of the draft Regulation states that 'to better mobilise local potential it is necessary to facilitate community-led local development .... Responsibility ... should be given to Local Action Groups (LAGs) representing the interests of the community... ', most rural (and urban) areas already have structures that represent the interests of the local community, i.e. communes, councils or other local government structures. These have advantages over LAGs in that they are representative of the local population; they are democratically accountable and have already established administrations with the capacity to manage budgets. Attention should be paid to ensure that the LEADER approach offers a real added-value over the alternative of channelling the funding for local development strategies through these existing bodies.
Articles 32 to 40	The term 'financial instrument' should be defined. The term is commonly used in the financial industry to designate securities or contracts providing their holder (or owner) with a claim. Such instruments are typically loans, guarantees, equity or quasi-equity investments or participations or other risk-bearing instruments. A similar definition is used in the proposal for amendment of the Financial Regulation (art. 130). However, Article 33 of the draft general Regulation does not refer to the above mentioned instruments, but to vehicles that provide financial instruments, i.e. fund of funds and funds. The Regulation should further clarify whether and under which conditions the provision of working capital is eligible for support and whether there should be a ceiling for management costs borne by the EU.
Article 32	Article 32 provides that an intervention may be justified not just by market failures but also in 'sub-optimal investment situations'. Without further precisions, this could lead to support for poorly justified financial instruments. The circumstances in which EU support for financial instruments may be available should be more narrowly defined in the draft general Regulation. For financial instruments strict rules have to be imposed - on the use of the bank accounts on which the CSF resources are deposited and - on the relevant accounting and reporting requirements. In particular, one bank account should be open for each FI,

	where all in- and outflows (initial contributions, loans granted, payment linked to guaranteed defaulted borrowers, premia, interests, returned resources, management fees) are respectively deposited/withdrawn. A separate accounting for the financial instruments should be kept, which should be reconciled with the bank account. Annual financial statements for the financial instruments should be prepared and audited. Failing to lay down these constraints entails the risk that, under the proposed legal framework, (a) financial instruments are used to circumvent the obligation of national co-financing and that (b) the auditors are unable to detect this breach of the EU regulation.
Article 32(2)	When final recipients are also beneficiaries of grants from various public sources (CSF funds, other EU grants, national/regional grants), the requirement to maintain separate records creates an additional complication, as the information reported would miss out on the actual level of public support received. In order to ensure completeness, the Annual Implementation Reports should report on a consolidated basis on the different sources of financing used for financial instruments in the programme area.
Article 33(3)	Article 33(3)(b) leaves the door open to funding vehicles not regulated by future implementing acts under Article 143.
Article 33(4)(a) and (c) (b)(i)	There is a risk of supporting Managing Authorities without significant experience in financial services. In addition to that, under Article 33(4)(a), a Managing Authority may recapitalise public banks or funds overloaded with liabilities as long as new investment vehicles are set up without any funding of new SMEs or SMEs particularly at risk. 'EIB' and not 'European Investment Bank' as only the former is a defined term and should comprise the EIF.
Article 35	This article allows declaring expenditure paid or expected to be paid to the financial instruments over a pre-defined period of maximum two years. It is unclear whether this means that the request for payment can include payments not yet incurred. In addition, Article 35(3) requires an adjustment of the eligible expenditure presented to take account of the difference between amounts paid to the financial instruments and by these instruments to the final recipients. It is not clear whether this requirement only refers to the disclosure of the adjustment or also to the adjustment of

	the total eligible expenditure recorded.
Articles 36(1), 55(2) and 114(4)	The capping of management costs per type of vehicle (fund of funds and other funds per type of financial instrument) should be regulated. As in the 2007-13 General Regulation, the Proposal is ambiguous regarding guarantees. Provided that a sound financing gap assessment has been prepared, guaranteed amounts of portfolio guarantees should be eligible expenditure. Article 36(1) is unclear whether portfolio guarantees committed during the eligibility period would be eligible even if the underlying instruments (e.g. loans) are issued after closure of the programming period.
Article 36(2)	Given the delays observed during operational programming, in the case of Venture Capital funds, the extension of the period for eligible expenditure should be longer (e.g. 10 years), which, in combination with the respect of *pari passu* and leverage requirements, would help EU funds delivering increased legacy funding.
Articles 37 and 39	As under the 2007-13 Regulation, it is unclear whether interest and other gains attributable to EU support paid to financial instruments should be used for the same type of financial instruments and for how long after closure (revolving nature of interest and capital gains). As per Article 39, legacy funding (including gains and other earnings) may be used to fund grant schemes, therefore limiting the revolving effect.
Article 38(1) and (2)	In its Communication on the financial rules applicable to the EU Budget, the Commission indicates the need to increase the leverage of EU funds as the rationale to use financial instruments. However, this Article fails to address sound financial management issues: - It adds the distinction between capital resources paid back and other resources, which would imply technical difficulties in determining the amount to set aside to pay for the management costs. - The re-use 'in accordance with the aims of the programme(s)' gives no legal certainty that the public sector sets funds aside. - The preferential remuneration of investors is foreseen as a standard, without being balanced by leverage or other requirements. Preferential treatment of investors in case of fund liquidation has not been addressed.

	- The *pari passu* principle, applied under the Multiannual programme for enterprises and entrepreneurship (MAP) and the Competitiveness and Innovation Framework Programme (CIP) (for equity instruments) has not been referred to. It leaves the EU funds subject to any kind of preferential treatment. Alternatively, the Commission could refer to the alignment of interest principle. Without further clarification, the EU legacy funding foreseen for future SMEs is at risk. In addition, resources returned to and revenues earned by the financial intruments should not be re-directed elsewhere before the closure of the operational programme, as it is proposed in Article 38(1) and 38(2): such resources should return to the relevant financial instruments.
Article 38(3)	The period during which records pertaining to the re-use of resources have to be kept and may be audited is not defined.
Article 39	Article 39 defines to re-use of financial instrument resources attributable for CSF Funds (10 years after the closure of the programme). It is still not clear however how this will be monitored. Whilst the definition of the minimum revolving period of 10 years is welcomed, it does not take into account the specificities of the different types of financial instruments and is not detailed in terms of leverage ratios and indicators. The possibility to recycle in the form of grants after closure of the programme has not been specified. After the closure of the programme (2022) and in the case of equity funds benefiting from legacy funding follow-on investments have been made impossible.
Article 40(2)(b) and (g)	The wording used in (b), 'description of the financial instrument and implementation arrangements', is imprecise (Article 44(2) of Commission Regulation (EC) No 1828/2006 contains more adequate wording) and in (g) confuses the reader with a 'multiplier effect', which is not defined. Recital 22 correctly refers to the 'leverage effect', not the 'multiplier effect'. Furthermore, the multiplier effect strongly differs between equity, loan and guarantee instruments, a fact not recognised in this draft general Regulation.

Article 44	The Member States shall submit a final report on the implementation of the programme by 30 September 2023 for the ERDF, ESF and CF and an annual implementation report for the EAFRD and EMFF. It is not clear why this distinction is made between the structural funds on one hand and the EAFRD and EMFF on the other hand.
Articles 51 and 52	The Court takes the view that technical assistance should support the generation and upgrading of 'local lasting institutional capability' which goes beyond the generation and implementation of a single project or the carrying out of related operations with the help of external expertise.
Article 56	This Article introduces new forms of support, such as prize and repayable assistance. No definition however, especially for prize, is provided. The conditions for repayable assistance should be more detailed, for example for state aid schemes.
Article 57	It is unclear at which level the possible methods are to be defined and monitored. It would not be acceptable that the calculation method is established by the beneficiaries. It is unclear whether the simplified cost method can be used for cost categories which were subject to procurement as well.
Article 58	The acceptable direct and indirect costs are to be clarified.
Article 59	The 'period of support for the operation' in Article 59(2)(c) and the 'permitted higher percentage' in Article 59(3)(b) needs to be defined.
Article 60(2)(b)	It is unclear why a different approach is followed between the two groups of funds.
Article 60(2)(d)	The sort of agreements envisaged needs to be clarified.
Article 61(1)	Article 61(1) should clarify that it is in any event the Member State that should reimburse EU funds, regardless whether it has recovered the funds from final recipients.
Article 63(2)	It would be useful to make reference also to the principles laid down in Article 62.

Article 64	Reference should be made to the criteria set by the Commission (Article 117(1)).
Article 76	It is unclear what is meant by veracity of the annual accounts.
Article 77	Article 77(2) seems to suggest that financial corrections will be applied only to compliance issues. This would be inconsistent with Article 20(4). Article 77(4) of the draft general Regulation stipulates that the criteria and the procedures for applying financial corrections shall be laid down in the Fund-specific rules, but the Fund Regulations are silent in this respect.
Article 84(4) and (5)	It is unclear how these amounts will be divided-up by Member State.
Article 90	There is no conceptual or legal argument why financial instruments could not be considered as major projects if their combined size exceeds 50 million euro. On the contrary, there is a lost opportunity here, as recognition as a 'major project' could be a way to promote the creation of fund of funds with sufficient critical mass, considering the legal certainty a Member State obtains after applying for a 'major project'.
Articles 91 and 92	The funding gap issue is not resolved; it is unclear whether the funding gap needs to be applied for interim payments.
Article 97(1)	It should be provided that the Commission definitively participates in the steering committees.
Article 100	This article overlaps with Article 43.
Article 110(7)	The Court advises the Commission to further define the framework of the 100 % co-financing option for financial instruments and to address the risks - that CSF funds crowd out EU funds managed centrally by the Commission, and

	- that the combined legacy funding of CSF and other EU funds remains subject to de-commitments.
Article 117(4)	The Commission should be in a position to request the report and the opinion of the independent audit body and the description of the management and control system for all operational programmes, independently from the amount of EU support.
Article 130	The Court recommends specifying an additional date at which the Annual Managment Declaration needs to be produced to make the proposed timetable work.
Article 131	There are several uncertainties about this proposed procedure, for instance with regard to the deduction of revenues for already completed projects. The arrangements for ERDF/CF and the ESF should be aligned, i.e. for ESF the rolling closure should also apply to 'operations' and the related expenditure rather than just 'expenditure'.
Article 132	This provision limits the Court's powers and leaves solely to the Commission the possibility to ask for an extension of the availability period. With the new electronic systems to be used it is important to clarify what form of documents can be accepted as audit evidence (i.e. use of certification of conformity of documents at national level – point 5, and security standard of electronic documents – point 6).
Article 137(2)	The Court recommends specifying that the examination should not only be subject to the agreement of the Commission but also that the latter has responsibility for verifying the nature and extent of the examination undertaken and the appropriateness of the conclusions drawn.
Article 140	The Court notes that there is no evidence that operations whose eligible expenditure is below 100 000 euro are less error prone than other operations. The Regulation should clarify how proportional controls will affect the sampling to be done by the audit authorities.

This Opinion was adopted by the Court of Auditors in Luxembourg at its meeting of 15 December 2011.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President