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COVER NOTE

from: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 19 October 2011

to: Mr Uwe CORSEPIUS, Secretary-General of the Council of the European
Union

No Cion doc.: C(2011) 7321 final

Subject: Commission decision of 19.10.2011 on the approval of guidelines on the
principles, criteria and indicative scales to be applied in respect of financial
corrections made by the Commission under Articles 99 and 100 of Council
Regulation (EC) No 1083/2006 of 11 July 2006

Delegations will find attached Commission document C(2011) 7321 final.

Encl.: C(2011) 7321 final



EUROPEAN COMMISSION

Brussels, 19.10.2011
C(2011) 7321 final

COMMISSION DECISION

of 19.10.2011

on the approval of guidelines on the principles, criteria and indicative scales to be applied in respect of financial corrections made by the Commission under Articles 99 and 100 of Council Regulation (EC) N° 1083/2006 of 11 July 2006

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) N° 1083/2006 of 11 July 2006, and in particular Articles 99 and 100 thereof,

Whereas:

- (1) The purpose of the guidelines is to provide guidance on the principles, criteria and indicative scales to be applied in respect of financial corrections made by the Commission under Articles 99 and 100 of Council Regulation (EC) No 1083/2006 of 11 July 2006. Under these articles, the Commission may make financial corrections by cancelling all or part of the Community contribution to an operational programme.
- (2) The guidelines, which are based on guidelines previously adopted by the Commission on 2 March 2001 [C(2001)476] for corrections in the Structural Funds for the 2000-2006 programming period, have been revised to reflect the regulatory framework applicable for the 2007-2013 programming period and to provide clarification in several areas.
- (3) The guidelines are to be used by the Commission's services to ensure equal treatment between Member States and proportionality when applying financial corrections in relation to Structural Funds assistance. The purpose of financial corrections is to restore a situation where all of the expenditure declared for co-financing from the Structural Funds is legal and regular, in line with the applicable national and Union rules and regulations.

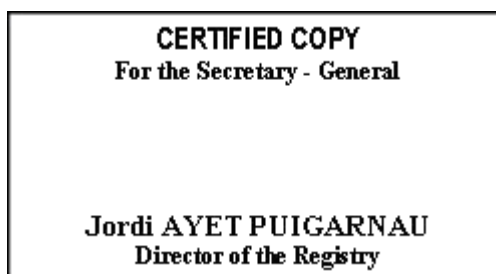
HAS DECIDED AS FOLLOWS:

Sole Article

The Commission guidelines on the principles, criteria and indicative scales to be applied in respect of financial corrections made by the Commission under Articles 99 and 100 of Council Regulation (EC) N° 1083/2006 of 11 July 2006 are approved.

Done at Brussels, 19.10.2011

For the Commission
Johannes HAHN
Member of the Commission



ANNEX

Guidelines

on the principles, criteria and indicative scales to be applied in respect of financial corrections made by the Commission under Articles 99 and 100 of

Council Regulation (EC) N° 1083/2006 of 11 July 2006

INTRODUCTION

The purpose of this document is to provide guidance on the principles, criteria and indicative scales to be applied when determining financial corrections made by the Commission under Articles 99 and 100 of Council Regulation (EC) No 1083/2006 of 11 July 2006¹ (hereinafter – "Regulation (EC) No 1083/2006").

Member States often detect irregularities during their controls. In such cases, they are required to make the necessary corrections in accordance with Article 98 of Regulation (EC) No 1083/2006. It is recommended that the Member States apply the same criteria and rates when correcting irregularities detected by their own services during the checks and audits carried out in accordance with Articles 60(b), 61(b) and 62(1)(a) and (b) of Regulation (EC) No 1083/2006 and other checks, unless they wish to apply more detailed rules, respecting these guidelines and the principle of proportionality.

1. DEFINITIONS AND PRINCIPLES

- 1.1. In accordance with Articles 99 and 100 of Regulation (EC) No 1083/2006 the Commission may make financial corrections by cancelling all or part of the Union contribution to an operational programme.
- 1.2. The purpose of financial corrections is to restore a situation where all of the expenditure declared for co-financing from the Structural Funds and the Cohesion Fund is in line with the applicable rules and ensuring, inter alia, respect of the principles of equal treatment and proportionality.
- 1.3. When deciding upon the amount of a correction on the basis of Articles 99 and 100 of Regulation (EC) No 1083/2006, the Commission takes into account the nature and gravity of the irregularity/ies² and the extent and financial impact of the identified deficiencies in the management and control system. In this regard the following should apply:
 - if the applicable rules are respected and all reasonable measures are taken to prevent, detect, report and correct fraud and irregularities, no financial corrections will be required.
 - if the applicable rules are respected but the management and control systems need only minor³ improvement there should be pertinent recommendations, but no financial corrections need be envisaged;
 - if an irregularity is established in an individual operation a financial correction should always be made;

¹ OJ, L 210, 31.7.2006, p. 25.

² The term 'irregularity' is defined in Article 2(7) of Regulation (EC) No 1083/2006.

³ See Guidance document on a common methodology for the assessment of management and control systems in the Member States (2007-2013 programming period).

- if there are serious deficiencies⁴ in the management or control systems which led or could lead to systemic irregularities, in particular, failures to respect the applicable rules, financial corrections should always be made.

1.4. An irregularity is defined in Article 2(7) of Regulation (EC) No 1083/2006 as: "*any infringement of a provision of Community law resulting from an act or omission by an economic operator which has, or would have, the effect of prejudicing the general budget of the European Union by charging an unjustified item of expenditure to the general budget.*"

Irregularities can be of an individual nature or of a systemic nature.

An **individual irregularity** is a one-off error which is independent of other errors in the population or deficiencies in the systems.

A **systemic irregularity** is an error, repeated or not, resulting from the existence of serious deficiencies in the management and control systems for which requirements are set out in Title VI of Regulation (EC) No 1083/2006.

System deficiencies are weaknesses in the management and control system (See sub-section 2.2).

The amount of the financial correction is assessed, wherever possible, on the basis of individual cases and is equal to the exact amount of expenditure wrongly charged to the EU budget. However, precisely quantified corrections are not always possible or cost effective if extensive additional verification work is needed. In such cases a flat rate correction, proportionate to the seriousness of the **irregularity** or the **system deficiency**, should be made.

1.4.1. *Quantifiable corrections*

The financial impact of an **irregularity** is quantifiable precisely when it is possible, on the basis of an examination of the individual cases, to calculate the exact amount of expenditure wrongly declared to the Commission (e.g. ineligible expenditure). In such cases the financial correction should be calculated exactly.

1.4.2. *Non-quantifiable corrections*

In other cases, due to the nature of the **irregularity** or **system deficiency**, it may not be possible to quantify precisely the financial impact (e.g. public procurement or publicity rules not complied with). In these cases, a flat rate correction should be applied to the individual operation based upon the seriousness of the **irregularity** or **deficiency** identified. The criteria and scales to be used for flat rate corrections are set out at section 2.

In the case of a serious **deficiency in the management and control system**, (e.g. ineffective management verifications or audits - see sub-section 2.2), but

⁴ See Guidance document on a common methodology for the assessment of management and control systems in the Member States (2007-2013 programming period).

where it is not possible to quantify the financial correction precisely, a flat rate correction should be applied to the expenditure declared for the part of the system affected in accordance with the indicative criteria and scales set out in section 2.

1.4.3. *Extrapolated corrections*

Where irregularities have occurred in a great number of operations throughout a priority or programme, but it is not cost-effective to verify the regularity of operations not included in the audited sample, the financial correction may be based on extrapolation.

Extrapolation should only be used for operations subject to a common management and control system, as referred to in Article 71(4) of Regulation (EC) No 1083/2006. In this case, the results of a thorough examination of a representative sample of the individual cases concerned are extrapolated to all expenditure in the population, in accordance with generally accepted auditing standards.

- 1.5. The Member State is always given the opportunity to demonstrate, through an examination of the documentation concerned, that the actual extent or gravity of the irregularity and therefore the real loss or risk to the EU budget was less than that assessed by the Commission. The Court of Justice has held that the significant part of the burden of proof in such cases falls on the Member State⁵. In agreement with the Commission, the Member State may limit the scope of this examination to an appropriate proportion or sample of the documentation concerned. The procedure and time limits are set out in Article 100 of Regulation (EC) No 1083/2006.
- 1.6. Where the Commission bases its position on facts established by auditors other than those of its own services, it draws its own conclusions regarding the financial consequences after examining the measures taken by the Member State concerned under Article 98(2) of Regulation (EC) No 1083/2006, the reports supplied under Article 70(1) (b) of Regulation (EC) No 1083/2006 and any replies from the Member State.
- 1.7. Ad hoc inter-service advisory panel

An ad hoc inter-service advisory panel, comprising representatives of the relevant services gives careful consideration to the proportionality of the correction rates proposed in order to ensure equal treatment both among and within Member States. The purpose is to ensure that the proposed corrections are properly justified. In cases of financial corrections made by the Commission involving either an extrapolated or flat-rate correction on the system the proposed financial correction is submitted to an ad hoc inter-service advisory panel, which will consider the arguments presented by the relevant Commission services for applying the financial correction and assess whether the level is appropriate.

⁵ See Case C-54/95, Germany v. Commission, para. 35.

1.8. Additionality

The method for calculating the amount of a financial correction to be applied in cases where the Member State does not respect the principle of additionality is set out at Article 38(2) of Regulation (EC) No 1828/2006⁶.

2. CRITERIA AND SCALES FOR FLAT-RATE CORRECTIONS

2.1. Criteria

As noted in sub-section 1.4, flat-rate corrections may be envisaged when the information resulting from the enquiry does not permit the financial impact of an **irregularity** to be quantified precisely either by statistical means or by reference to other verifiable data.

Flat-rate corrections should be considered when the Commission identifies a failure to adequately carry out any control explicitly required by regulations applicable to the Structural Funds or the Cohesion Fund. They should also be considered where the Commission identifies **serious deficiencies in management and control systems** resulting from breaches of the applicable rules or from a breach of the principle of sound financial management. Flat-rate corrections can also be appropriate when the Member States' authorities discover such **irregularities** or **deficiencies** but the Member State fails to take appropriate and timely corrective action (e.g. a failure to implement financial corrections).

In addition, flat-rate corrections can also be applied in respect of **individual irregularities**.

In determining whether a flat-rate financial correction should be applied and, if so, at what rate, the assessment of the degree of risk of loss to which the EU budget was exposed due to the control deficiency should be taken into consideration. Thus, the correction should be in compliance with the principle of proportionality. The specific elements to be taken into account should include the following:

- whether the **irregularity** is related to an individual or multiple cases;
- whether the **deficiency** is a **serious deficiency** in the overall management and control system or relates to a particular element of the system (i.e. to the operation of particular functions necessary to ensure the legality and regularity of expenditure declared for co-financing from the Funds under the applicable rules) - see sub-section 2.2;
- the importance of the **serious deficiency** within the totality of the administrative, physical and other controls foreseen;
- the vulnerability to fraud of the systems.

⁶ OJ, L 371, 27.12.2006, p.1.

2.2. Identified **deficiencies in management and control systems**

Management and control systems consist of various elements or functions for ensuring the legality, regularity and eligibility of expenditure declared for co-financing. For the purpose of determining flat-rate corrections for serious deficiencies in such systems, it is useful to identify the key elements of the management and control systems and to provide the related regulatory references.

The key elements⁷ are those which have been designed for and are essential in ensuring the legality and regularity of expenditure and the reality of operations.

A list of the key elements by authority is set out below.

Managing authority / Intermediate body/ies

- Clear definition, allocation and separation of functions between and within the managing authority / intermediate body/ies (Article 58(a), (b) and (e), Articles 59(2), 59(3) and 60 of Regulation (EC) No 1083/2006 and Articles 12, 13(5) and 22(b) of Regulation (EC) No 1828/2006);
- Adequate procedures for the selection of operations (Articles 60(a) and 65(a) of Regulation (EC) No 1083/2006 and Articles 5 and Article 13(1) of Regulation (EC) No 1828/2006);
- Adequate information and strategy to provide guidance to beneficiaries (Articles 56 as well as 60(c), (d) and (f) of Council Regulation (EC) No 1083/2006 and Article 13(1) of Regulation (EC) No 1828/2006);
- Adequate management verifications (Article 60(b) and (g) of Regulation (EC) No 1083/2006 and Article 13(2) - (4) of Regulation (EC) No 1828/2006);
- Adequate audit trail (Article 60 (c), (d) and (f) as well as Article 90 of Regulation (EC) No 1083/2006 and Article 15 of Regulation (EC) No 1828/2006);
- Reliable accounting, monitoring and financial reporting systems in computerised form (Article 58 (d) and 60(c) of Regulation (EC) No 1083/2006, Article 14(1) and Annex III of Regulation (EC) No 1828/2006);
- Necessary preventive and corrective action where systemic errors are detected by the audit (Article 98(1) of Regulation (EC) No 1083/2006 and Article 16(3) of Regulation (EC) No 1828/2006).

Certifying authority / Intermediate body/ies

- Clear definition, allocation and separation of functions between and within the certifying authority / intermediate body/ies (Article 58(a) and (b), Article 59(2) and Article 61 of Regulation (EC) No 1083/2006 and Article 12 of Regulation (EC) No 1828/2006);

⁷

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

- Adequate audit trail and computerised system (Article 61(b) and (e) of Regulation (EC) No 1083/2006, Article 15 of Regulation (EC) No 1828/2006);
- Adequate arrangements for the certification of expenditure to be reliable and soundly based (Article 61 (b) (c) and (d) of Regulation (EC) No 1083/2006);
- Satisfactory arrangements for keeping an account of amounts recoverable and for recovery of undue payments (Article 61(f) of Regulation (EC) No 1083/2006 and Article 20(2) of Regulation (EC) No 1828/2006).

Audit authority

- Clear definition, allocation and separation of functions (Article 58(a) and (b) and Article 62(3) of Regulation (EC) No 1083/2006, Article 23(a),(b) and (d) of Regulation (EC) No 1828/2006);
- Adequate systems audits (Article 62(1)(a) of Regulation (EC) No 1083/2006 and Article 23(c) of Regulation (EC) No 1828/2006);
- Adequate audits of operations (Article 62(1)(b) and Article 98(4) of Regulation (EC) No 1083/2006, Articles 16 – 17 and 23(c) and Annex IV of Regulation (EC) No 1828/2006);
- Adequate annual control report and audit opinion (Article 62(1)(d), (i) and (ii) of Regulation (EC) No 1083/2006 and Article 18(2) and Annexes VI and VII of Regulation (EC) No 1828/2006).

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 **irregularity** is, so serious as to constitute a complete failure to comply with the rules, so rendering all the relevant payments irregular. In the case of fraud and where the Member State has been negligent, the Commission may apply a net financial correction of 100%.

25% correction

When the 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 result in exceptionally high losses to the EU budget.

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 the management and control **system does not function or functions 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 EU budget.

This rate of correction is also appropriate for individual or systemic **irregularities** of moderate seriousness.

5% correction

When the management and control system functions **but not with the consistency, frequency, or depth** required by the EU regulations, then a correction of 5% is justified, as it can reasonably be concluded that it does not provide a sufficient level of assurance of the regularity of claims, and that the risk to the EU budget was significant.

A 5% correction can also be appropriate for less serious individual or systemic **irregularities** in individual operations.

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 the EU rules and the deficiency must expose the Structural Funds and the Cohesion Fund to a real risk of loss or irregularity.

In accordance with the principle of proportionality, the correction rate may be reduced to between 2% and 5% where the nature and gravity of the deficiency, either individual or systemic, although serious, is not considered to justify a 5% correction rate.

2.4. Repeated breaches

Flat-rate corrections can be increased 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.

2.5. Borderline cases

Where the correction resulting from a strict application of the rates of 100%, 25% or 10% set out at section 2.3 would be clearly disproportionate, a lower rate of correction may be proposed. The ad hoc inter-service advisory panel should give careful consideration to the proportionality of corrections.

2.6. Basis of assessment

Whenever the situation in other Member States is known, this should enable the ad hoc inter-service advisory panel to make a comparison between them to ensure equal treatment in the assessment of the rates of correction.

The rate of correction should be applied to that part of the expenditure placed at risk at programme or priority axis level, taking full account of the proportionality principle.

The correction should be applied to the expenditure placed at risk and for the period affected.

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 risk presented by the management and control system as a whole.

They are applied to the expenditure remaining after the deduction of the amounts corrected with regard to individual cases.

3. APPLICATION AND EFFECT OF NET FINANCIAL CORRECTIONS

Where the Member State agrees to make the financial correction proposed in the procedure under Article 99(1) of Regulation (EC) No 1083/2006, the Commission need not impose a net reduction in the funding to the programme but allow the Member State to re-use the Funds released in accordance with Articles 98(2) and 98(3) of Regulation (EC) No 1083/2006. However, financial corrections imposed by a Commission decision under Article 100(5) of Regulation (EC) No 1083/2006 after completion of the procedure laid down by Article 100(1) to 100(4) will involve a net reduction in the Member State's indicative allocation of funding under Article 18(2) of Regulation (EC) No 1083/2006.

Interest on any sums to be reimbursed to the Commission following net corrections should be charged under Article 102(2) of Regulation (EC) No 1083/2006.