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Special Report

Financial instruments in cohesion policy at closure of the 2007–2013 period:

verification work yielded good results overall, but some errors remained

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Contents

Executive summary

I Financial instruments were a relatively new but important method of cohesion policy financing in the 2007-2013 programming period. Over 1 000 financial instruments under shared management (FISM) were used across 25 Member States, with operational programme contributions exceeding €16 billion, including €11 billion in EU funding through the European Regional Development Fund and the European Social Fund. Our previous audits concerning these instruments revealed a number of errors and weaknesses during implementation. The Commission stated that these shortcomings would be addressed at closure.

II The audit objective was to analyse whether the Member States and the Commission had taken the necessary steps to properly verify and assess FISM expenditure at closure of the 2007-2013 operational programmes. The audit scope did not include providing assurance on final 2007-2013 FISM expenditure. We decided to wait until now to audit and report on this subject as the closure process takes a long time. When we started our audit work in June 2020, 23 % of 2007-2013 operational programmes with FISMs were still not fully closed (3 % due to unresolved FISM issues).

III As financial instruments have an even greater role and increased reach in cohesion policy for the 2014-2020 programming period, our conclusions on 2007-2013 FISM expenditure at closure will be relevant for the upcoming 2014-2020 closure process. The overall importance of financial instruments will increase further in the 2021-2027 programming period.

IV We found that the Member States and the Commission had largely taken the necessary steps to verify the eligibility of FISM expenditure at closure. The Commission and the national audit authorities had carried out checks, and these had yielded results. Despite this, however, we still identified errors with a financial impact in three of the seven instruments we audited during our legality and regularity audits at closure.

V The Commission had taken the necessary steps to approve final expenditure, with one noteworthy exception. It accepted as eligible a FISM that disbursed more than 80 % of funds to large corporations (some publicly listed), instead of disbursing primarily to small and medium-sized enterprises as per the applicable legislation.

VI Most of the shortcomings we identified, such as limitations on the audit authorities' mandate, have been addressed for 2014-2020. For the remaining weaknesses, the Commission is updating its financial instrument audit methodology and developing guidance on audit documentation practices in cooperation with audit authority representatives.

VII In our 2018 annual report, we recommended that the Commission clarify the 2014-2020 legislative provisions for closure. The provisions do not define the role of each actor in the closure process or the work needed to reassess and, if necessary, adjust the impact of possible ineligible costs on the residual rates for the years in question. Audit authorities are not explicitly required to provide assurance on total expenditure. These omissions are particularly relevant for financial instruments, where the eligibility of a material part of the expenditure may only be assessed at closure. The Commission is implementing our recommendation and is currently finalising guidelines so that Member States understand what is expected from them at closure.

VIII The Commission's final report on the implementation of 2007-2013 FISMs presented data as at 31 March 2017, the date on which the Member States were required to submit the closure documents. It did not capture the adjustments and corrections of subsequent closure work. The Commission does not intend to publish an updated report showing the corrected final data. Data reliability in the implementation reports improved over the years and this trend appears ongoing for 2014-2020 reporting.

IX The final report also assesses the performance of 2007-2013 FISMs. This assessment is however incomplete due to the lack of data on leverage and intra-period reuse of funds (revolving effect), two relevant indicators that are among the main advantages of using financial instruments instead of grants. Data on leverage and intra-period reuse of funds is being collected for the 2014-2020 reports and the performance assessment has consequently improved.

X Based on our conclusions, we recommend that the Commission take the following actions for 2014-2020 financial instruments under shared management:

- Provide guidance targeting risk areas identified in Commission and ECA audits.
- Complete the necessary guidance on the role and responsibilities of audit authorities when assessing the eligibility of financial instrument expenditure at closure.

Introduction

Audit area

01 In EU cohesion policy, financial instruments are a newer, alternative implementation method to traditional grants. They consist of a variety of financial products (see ***Table 1***) and are designed to have a revolving nature. At the end of the agreed repayment period, the funds are to be reinvested for similar purposes to maximise the impact of public investments.

Table 1 – Main types of financial instrument supported by the EU budget

Loan	Guarantee
"Agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time". Can offer lower interest rates, longer repayment periods or lower collateral requirements compared to market conditions.	"Written commitment to assume responsibility for all or part of a third party's debt or obligation or for the successful performance by that third party of its obligations if an event occurs which triggers such guarantee, such as a loan default". Guarantees normally cover financial operations such as loans.
Equity	**Quasi-equity**
"Provision of capital to a firm, invested directly or indirectly in return for total or partial ownership of that firm and where the equity investor may assume some management control of the firm and may share the firm's profits". The financial return depends on the growth and profitability of the business.	"A type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity". Quasi-equity investments can be structured as debt and in some cases are convertible into equity.

Source: FI Compass – "Financial Instrument products".

02 Financial instruments can be set up as standalone funds or as specific funds in a holding fund structure. A holding fund is usually set up to manage multiple specific funds or different types of products. In shared management, a holding fund or a specific fund can also receive contributions from multiple operational programmes (OPs).

03 When implemented correctly, financial instruments offer certain advantages compared to grants:

- the repayment of the funds can lead to their reuse in new projects (revolving effect), thereby providing sustainability;
- the repayment obligation gives beneficiaries a strong incentive to implement successful projects that deliver results, improving the effectiveness of EU support;
- the ability to bring in private sector investment (leverage) can result in a more cost-effective use of EU support.

Materiality and risks at closure

04 At the end of the 2007-2013 period, there were 1 058 FISMs[1] across 25 Member States[2]. The total value of OP contributions paid to the instruments amounted to €16.4 billion, including EU co-financing of €11.3 billion through the European Regional Development Fund (ERDF) and, to a much lesser extent, the European Social Fund (ESF) with the oversight of the Commission’s Directorate-General for Regional and Urban Policy (DG REGIO) and Directorate-General for Employment, Social Affairs and Inclusion (DG EMPL).

05 Financial contributions from OPs to FISMs were generally made through a single payment as soon as the legal structure was set up. In accordance with Regulation 1083/2006[3] (“the general regulation”), managing authorities declared these contributions to the Commission together with the expenditure incurred for grants[4]. For closure[5], only disbursements made to final recipients, guarantees provided (including amounts committed), and management costs and fees were considered eligible[6]. The resources returned or to be returned from eligible investments become

[1] In this report, unless specified otherwise, the term refers exclusively to ERDF and ESF financial instruments under shared management for the 2007-2013 programming period.

[2] All Member States except Croatia, Ireland and Luxembourg.

[3] Council Regulation (EC) No 1083/2006 of 11 July 2006 (OJ L 210, 31.7.2006, p. 25).

[4] Article 78a of Regulation (EC) No 1083/2006.

[5] In this report, unless specified otherwise, the term refers exclusively to the closure of operational programmes for the 2007-2013 programming period.

[6] Article 78(6) of Regulation (EC) No 1083/2006.

legacy resources and must be reused by the Member State for similar purposes in accordance with specific rules, no longer representing EU resources.

06 *Table 2* describes the responsibilities of Member State programme authorities and the Commission in the closure process:

Table 2 – Responsibilities in the closure process

Authority	Role
Managing Authority	Submits the final implementation report covering the entire period[1].
Certifying Authority	Submits the application for payment of the final balance and the final statement of expenditure[2].
Audit Authority	Submits a closure declaration to the Commission, supported by a final control report. The closure declaration assesses the validity of the application for payment of the final balance and the legality and regularity of the underlying transactions covered by the final statement of expenditure[3].
Commission	Analyses the documents submitted by the Member States and gives an opinion on the final implementation report and the closure declaration. During the closure process, clarifies and settles all unresolved issues related to control and audit activities, conducting further audits and applying financial corrections as necessary. Pays final balance once process is completed[4].

1 Article 67 of Regulation (EC) No 1083/2006.
2 Articles 61, 78 and 89 of Regulation (EC) No 1083/2006.
3 Article 62(1)(e) of Regulation (EC) No 1083/2006.
4 Articles 67(4), 89(3) and 89(4) of Regulation (EC) No 1083/2006.

Source: Regulation (EC) No 1083/2006.

07 Our statement of assurance audits for the 2007-2013 programming period and several of our special reports revealed a number of errors in FISM expenditure as well as weaknesses during implementation. The Commission acknowledged these concerns and indicated that, in line with their multiannual approach, they would address them through eligibility verifications at closure. Therefore, the risks at closure relate to the robustness of the verification procedures applied by the audit authorities and the Commission.

08 As FISMs generally received the programme contribution through a single advance payment, and the eligibility of the actual amounts invested was not generally audited during implementation, the bulk of eligibility verification by the Commission and Member States needed to be performed at closure. We highlighted this as early as in our 2010 annual report[7]. ***Annex I*** lists other annual and special reports in which we emphasized the importance of closure verifications in this area.

[7] See paragraph 4.36 of the ECA 2010 Annual Report.

Audit scope and approach

09 The objective of this audit was to analyse whether the Member States and the Commission had taken the necessary steps to properly verify and assess FISM expenditure at the closure of OPs from the 2007-2013 programming period. In this context, the audit focused on how the Member States and the Commission verified the eligibility of the declared expenditure. We also examined how the Commission analysed the data reliability in the final report and how it evaluated this data. We therefore assessed whether, for FISM expenditure at closure:

- the Commission provided timely and relevant guidance;
- the audit authorities carried out effective verifications;
- the Commission carried out effective verifications;
- the Commission assessed the final implementation data to draw conclusions on the performance of FISMs; and
- the weaknesses highlighted by this audit are likely to impact the 2014-2020 closure of financial instruments.

10 We performed our audit as a desk review utilising evidence from our previous FISM audits at closure and from the Commission's own closure work. Specifically, we obtained our audit evidence from the following sources:

- review of the seven FISMs we audited for our 2017 and 2018 statement of assurance work (the audit therefore captures the results of audits in Germany (2), Lithuania, Poland, Spain (2) and Sweden);
- interviews with officials from DG REGIO and DG EMPL;
- analysis of other closure documents available from the Commission, e.g. reviewing a judgmental sample of 27 closure packages[8];

[8] (1) the application for payment of the final balance and a statement of expenditure in accordance with Articles 61, 78 and 89 of Regulation (EC) No 1083/2006; (2) the final implementation report for the programme in accordance with Article 67 of Regulation (EC) No 1083/2006; and (3) the closure declaration supported by the final control report in accordance with Article 62 of Regulation (EC) No 1083/2006.

- review of the final Summary of data report on FISM implementation prepared by the Commission at closure; and
- brief questionnaire sent to the managing authorities responsible for the seven FISMs listed above to complement the data obtained during the audits.

11 It is therefore not in the scope of this audit to provide:

- assurance on the final 2007-2013 FISM expenditure;
- an assessment of 2007-2013 FISM performance (we mention the performance indicators in order to provide information on the reporting tool used by the Commission and whether the indicators were used in the Commission's performance assessment); or
- a complete analysis of the 2014-2020 programme period control and assurance framework for financial instruments.

12 Our findings and conclusions are relevant at this time because financial instruments have an even greater role and increased reach in cohesion policy for the 2014-2020 programming period, and final closure for this period is approaching. In the 2021-2027 programming period, based on current plans for reduced cohesion policy resources, the overall importance of financial instruments will increase further.

13 Following our audits on FISM implementation[9] and the design of the closure procedures[10], this audit aims to complete the picture of the 2007-2013 FISMs.

14 We decided to wait until now to audit and report on a topic related to the 2007-2013 programming period because the closure process takes a long time. This is a result of the multiannual nature of programming periods as designed by the Commission. While the deadline for Member States to submit their closure packages was 31 March 2017, the verification and validation work is still ongoing, seven years after the end of the 2007-2013 programming period and five years after the eligibility period ended. At the time we started our audit work in June 2020, 23 % of OPs with FISMs (44 of 192) were not yet fully closed (3 % due to unresolved FISM issues).

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[9] ECA special report 19/2016.

[10] ECA special report 36/2016.

Observations

Commission guidance for FISM closure

Commission guidance was timely and adequate, except in one risk area

15 The applicable regulations contained six articles with provisions on FISMs, covering only four pages in total[11]. Additional, extensive and timely guidance was needed to allow the programme authorities[12] to successfully determine the eligibility of FISM expenditure at closure.

16 The Commission's closure guidance did include specific information for FISM expenditure[13]. In addition to extensive information on eligibility conditions, the guidance provided instructions on the more complex topics of guarantee funds, management costs, and interest generated. It covered reporting requirements through a template showing the detailed information required for each instrument.

17 The guidance listed the required contents of the managing authorities' final implementation report and the audit authorities' final control report with specific, detailed points for FISM expenditure[14]. It also contained instructions on the actions to be performed in preparation for closure by the managing and certifying authorities, and at closure by the audit authorities[15].

18 The Commission collected and answered a large number of closure-related questions from Member States, including 29 questions on FISM topics[16]. The answers provided detail on most of the complex FISM areas, contained multiple

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[11] Articles 44 and 45 of Regulation (EC) No 1083/2006 and Articles 43 to 46 of Commission Regulation (EC) No 1828/2006 of 8 December 2006 (OJ L 371 27.12.2006, p. 1).

[12] In this report references to the programme authorities are to be understood as the three Member State authorities listed in paragraph ***06*** above. These authorities may be national, regional or local.

[13] Commission Decision C(2015) 2771 final of 30 April 2015.

[14] Two key components of the closure package. Commission Decision C(2015) 2771 final of 30 April 2015, paragraphs 5.2, 5.3 and Annex VI.

[15] Commission Decision C(2015) 2771 final of 30 April 2015, Annex VI.

[16] Commission document Q&A on the 2007-2013 programmes closure.

recommendations from the Commission to programme authorities to submit the final expenditure well before the 31 March 2017 deadline, and advised audit authorities to perform thematic audits on FISMs.

19 In cooperation with the programme authorities, the Commission provided additional closure guidance through training sessions and seminars[17].

20 We found that the FISM closure guidance provided by the Commission was timely and addressed the necessary points. It was especially important given the brevity of the FISM provisions in the legislation. The guidance addressed most of the topics in which we found deficiencies during the implementation phase: management costs and fees ceilings, reporting accuracy, contractual requirements, and the calculation of eligible expenditure in the case of guarantee funds.

21 However, we identified the following weakness:

- The Commission did not address as a particular risk the evaluation of final recipients' small and medium-sized enterprise (SME) status, even though this was an eligibility requirement for most instruments. This area was of higher risk for FISMs because the SME-status assessment was performed by financial intermediaries (often private banks and other financial sector entities), not by managing authorities. As discussed later in this report, we identified errors concerning this point in our audits (paragraph ***35***).

Effectiveness of audit authorities' verification work at closure

EIB Group managed FISMs: some ineligible expenditure included due to audit mandate restrictions and external auditor's scope limitations

22 The applicable legislation clearly defined the audit authorities' functions for the 2007-2013 programming period[18]. They were required to submit the closure declaration to the Commission, supported by the final control report, evaluating the final balance payment request and providing an opinion on the legality and regularity

[17] Examples of these include the technical meetings with the audit authorities: (1) Homologues Group Meeting, September 2015, where the focus was on the closure of FISMs and (2) Homologues Group Meeting, September 2016.

[18] Article 62 of Regulation (EC) No 1083/2006.

of the amounts included in the final statement of expenditure. This evaluation was based on all the audit work performed for the programming period.

23 The EIB Group managed around 11 % of FISMs by number, or 16 % by OP contribution amount, in the 2007-2013 period. In all but one case it managed a holding fund structure and selected financial intermediaries to manage the specific funds[19]. For these structures, the audit authorities were not able to perform verifications at holding fund level due to access rights limitations imposed by the EIB Group[20].

24 Nor did they have a clear audit mandate in practice to perform verifications at specific fund or final recipient level, so most audit authorities did not carry out their work at any level. ***Box 1*** presents two examples of audit authorities' different audit approaches for FISMs managed by the EIB Group.

[19] ECA analysis of the Commission's final Summary of data report as at 31 March 2017 (closure).

[20] ECA 2014 Annual Report, paragraph 6.67, ECA 2015 Annual Report, paragraph 6.63.

Box 1

EIB-managed FISMs: different approaches, different results

For a FISM in Lithuania, the scope of the external auditor's Agreed-upon-Procedures[21] (AUP) report did not cover verifications of financial intermediaries or final recipients. Nevertheless, the audit authority carried out its own detailed testing at these levels as needed.

We audited this FISM for the 2018 statement of assurance and, in re-performing the audit authority's work, did not identify any ineligible expenditure.

For a FISM in Spain, similarly, the scope of the external auditor's AUP did not cover verifications of financial intermediaries or final recipients. The audit authority interpreted the limitation on their mandate for EIB Group managed instruments as preventing them from performing work at all levels. In order to obtain assurance for closure, the audit authority relied on the EIB's controls and the AUP.

We audited this FISM for the 2018 statement of assurance and identified ineligible expenditure.

25 In general, audit authorities relied solely on the AUP reports of the EIB Group's external independent auditor. These reports covered a number of specific verifications related to instrument set-up and implementation at holding fund level, but by their limited nature could not express any assurance on the eligibility of the expenditure disbursed by the financial instrument.

Extended eligibility period created more work for audit authorities and the Commission

26 As designed by the Commission and referred to above in paragraph ***14***, closure for the 2007-2013 programming period takes a long time. In 2015 the Commission's guidance on closure changed the final date for contributions from FISMs to final

[21] An AUP is a procedure agreed between an entity and a third party to produce factual findings about financial information or operational processes (ISRS 4400). See also DG REGIO 2017 AAR Annex, p. 75.

recipients from 31 December 2015 to 31 March 2017 effectively extending the eligibility period[22].

27 One of the main reasons for this extension of the eligibility period was the low absorption rates. Member States were required to return all unused funds to the Commission at closure. Without the extension, a significant amount of funds would have remained unused, as evidenced by the €2.6 billion in additional FISM expenditure disbursed between 1 January 2016 and 31 March 2017[23]. The estimated disbursement rate to final recipients increased from 75 % at 31 December 2015 to 93 % at 31 March 2017[24].

28 However, whilst it improved the absorption of funds, the extension created an issue for audit authorities. Allowing FISMs to make disbursements to final recipients until 31 March 2017 restricted the audit authorities' ability to obtain assurance that all expenditure was legal and regular in time for the deadline for submitting the closure declaration (also 31 March 2017).

29 The Commission was aware of the issue and strongly recommended in the closure guidance that managing and certifying authorities submit the final expenditure declaration and application for payment of the final balance to the audit authorities by 31 December 2016 rather than the 31 March 2017 deadline[25].

30 Despite these recommendations from the Commission, some FISM expenditure could not be included in the audit authorities' work for the closure declaration. The Commission does not know how much additional expenditure Member States declared between 1 January 2017 and 31 March 2017 and it was not possible to determine the amount from the information made available for our audit.

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[22] Commission Decision C(2015) 2771 final of 30 April 2015, paragraph 3.6. We reported on this in our 2014 Annual Report, paragraph 6.52 and our 2015 Annual Report, paragraph 6.45.

[23] ECA special report 19/2016, paragraphs 42-44. The amount is based on our calculation using the Commission's Summary of data reports as at 31 December 2015 and 31 March 2017.

[24] The Commission's Summary of data reports as at 31 December 2015 and 31 March 2017.

[25] Commission Decision C(2015) 2771 final of 30 April 2015, Annex 1, paragraph 4.2 and Annex VI, paragraph 11. See also the Commission responses to Member State concerns on this issue in Commission document Q&A on the 2007-2013 programmes closure, questions 88, 93, 98, 99.

31 We reviewed this aspect for a number of OPs with FISMs (27 out of 192 such programmes for Cohesion). Eleven of the 27 had scope limitations due to expenditure, including FISM expenditure, being declared after the date on which the audit authority drew its final sample for the closure declaration. While this expenditure was effectively excluded from the audit work presented in the closure packages submitted by 31 March 2017, it was audited later through additional work. This required additional time and resources from the Commission and the audit authorities, delaying the closure process and making it longer and less efficient.

The audit authorities performed most of the necessary verifications, but some errors remained undetected

32 We started to review the audit authorities' closure work at operation level beginning with the 2017 statement of assurance, following the programme authorities' submission of closure packages to the Commission. ***Box 2*** contains a snapshot of our audit work at closure.

Box 2

Our assessment of audit authorities' work at closure (2017 and 2018 ECA annual reports)[26]

We examined 19 closure packages (seven containing FISMs) for all of which the audit authorities had reported residual error rates under 2 %. We only found weaknesses in the audit authorities' sampling work in one of the 19 packages.

When shortcomings related to the scope, quality and documentation of the audit authorities' work arose, we re-performed the work at operation level. Due to the errors we identified in the review and re-performance process, we recalculated the residual error rate to above 2 % in four of the 19 packages. In one of the four, the reason for the increase was an important error we found on FISM expenditure.

33 In the seven statement of assurance audits of FISMs at closure (paragraph ***10***), we found that the audit authority checklists used were well designed. They covered the relevant aspects required by the legislation and the guidelines. However, while in

[26] ECA 2017 Annual Report, paragraphs 6.44-6.50 and ECA 2018 Annual Report, paragraphs 6.41-6.50.

general the audit authorities performed the necessary checks, we identified some weaknesses.

34 The main weaknesses we uncovered relate to incomplete eligibility checks. For example where the checklists require the auditor:

- to check that all public procurement requirements have been respected, addendums to contracts should also be checked and taken into account;
- to verify the SME status of a final recipient, all criteria for SME status should be taken into account, including the linked and partner company rules;
- to confirm the eligibility of a loan disbursement, an assessment of any cancellations or aborted operations should be performed at the time of the audit.

35 Due to these incomplete eligibility checks by audit authorities, we found cases of undetected ineligible recipients or disbursements in three of the seven statement of assurance audits (see ***Table 3***).

Table 3 – ECA 2017 and 2018 statement of assurance – ineligible recipients or disbursements

Error	Description
Ineligible financial instrument	The financial instrument as a whole was not compliant with the main eligibility requirement that it primarily finances SMEs.
Ineligible recipient	The loan recipient was not an SME, based on an analysis of linked companies.
Ineligible disbursements	Two loans declared as eligible disbursements had been cancelled well before closure.
Incorrect declaration of reused funds	Funds returned by final recipients from the first round of investments were reinvested and declared to the Commission for reimbursement a second time.

Source: ECA.

36 We also found shortcomings in the use of checklists (see ***Table 4***). These concerned insufficient documentation of the audit work performed and a lack of audit evidence collected to support results[27]. We could not verify the explanations provided by audit authorities using their audit documentation and other available evidence.

Table 4 – ECA 2017 and 2018 statement of assurance – shortcomings in use of checklists

Error	Description
Insufficient audit documentation	Audit checklist noted that management costs and fees were subject to a supplementary audit. In the audit documentation, there was no evidence of supplementary audit work or of additional documents reviewed.
Insufficient audit documentation and weaknesses in the work	The audit files cannot prove that the different tests covered all eligibility requirements. The testing of the SME criterion in case of entities linked to other entities was not always properly completed.
Insufficient audit documentation and insufficient audit trail	Verifications performed were not well documented in checklists, reports or other documents. References to relevant documents were missing. Audit evidence was not stored.

Source: ECA.

37 Overall, our statement of assurance work on FISMs at closure identified nine errors in six of the seven instruments audited. Three of these errors had a financial impact reducing the amount of eligible expenditure at closure. In one case, the error brought the residual risk of error for the OP above the 2 % materiality threshold, requiring the application of extrapolated financial corrections (see ***Box 3*** for details).

38 As part of this audit we also reviewed the closure packages and all subsequent interactions between the programme authorities and the Commission for 27 of 192 OPs with FISMs. We found that most audit authorities conducted their work in accordance with their audit strategies, taking into account the applicable regulations and guidance provided by the Commission. However, not all audit authorities

[27] See also ECA 2018 Annual Report, paragraphs 6.46-6.48.

systematically performed thematic audits[28] and where they did, the work was not always sufficient to identify material irregularities[29].

39 We found two weaknesses in the audit authorities' reporting for closure:

- In some cases the information on the work performed on FISM expenditure was too brief, resulting in requests for additional detail from the Commission's auditors, and leading to revised reports.
- In some cases, information on corrections applied to FISM expenditure was not available (amount, type). The final control reports we reviewed were not consistent on the detail provided. There was no requirement for the audit authorities to present their corrections by type (e.g., public procurement, state aid, financial instruments, etc.) and the Commission does not have structured data on this.

40 In general the audit authorities performed the necessary verifications. However, the weaknesses discussed above affected to an extent the reliability of their work and certain errors went undetected, as shown by the errors uncovered by us and the Commission.

Effectiveness of Commission verifications at closure

By the end of 2020, 19 % of OPs with FISMs were still not fully closed

41 After Member State programme authorities submitted their closure packages to the Commission by the regulatory deadline of 31 March 2017[30], the Commission analysed these packages and responded within the five-month deadline. Where applicable, the Commission requested information, asked for additional work to be performed or raised observations of varied importance and financial impact.

42 In many cases, interaction with the programme authorities to address closure issues continued beyond the initial observation letters and in some it is still ongoing.

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[28] A thematic audit is an audit of a specific key requirement or area of expenditure where the risk is considered to be systemic. Thematic audits complement regular system audits.

[29] ECA 2017 Annual Report, paragraph 6.35.

[30] DG REGIO 2017 Annual Activity Report, paragraph A.2.3 and DG EMPL 2017 Annual Activity Report, paragraph A.2.

Table 5 and *Table 6* present the status of the Commission's closure work as at 31 December 2020 on cohesion OPs containing FISMs.

Table 5 – Closure status of cohesion OPs with FISMs

Status	End 2018	End 2019	End 2020	Percentage end 2020
Closed	123	143	156	81 %
Pre-Closed[1]	39	32	32	17 %
Open	30	17	4	2 %
Total	**192**	**192**	**192**	

[1] The Commission considers an OP pre-closed if a pre-closure letter has been sent. In practice, an OP can be considered pre-closed for a number of reasons: if one fund in it is closed (e.g. ERDF) and the other open (e.g. CF); in mono-fund OPs, if all uncontested amounts were paid but contested amounts are still open; or if there are other specific open issues.

Source: ECA based on Commission data.

Table 6 – FISM declared expenditure at closure in cohesion OPs – before Commission corrections (in billion euros)

Status	End 2018	End 2019	End 2020	Percentage end 2020
Closed	6.73	8.60	9.96	64 %
Pre-Closed	4.41	3.75	3.32	21 %
Open	4.48	3.27	2.34	15 %
Total	**15.62**	**15.62**	**15.62**	

Source: ECA based on Commission data.

43 The information shows that 81 % of cohesion OPs with FISMs were fully closed by the end of 2020, representing OPs containing 64 % of total FISM declared expenditure for the period. Only five of the 36 open or pre-closed OPs, all in Italy, still have unresolved FISM issues.

44 The Commission requested FISM clarifications or additional work regarding the majority of these 36 OPs during the closure process. While this shows that FISMs were one cause of delays in the closure of these programmes, it is also indicative of the attention they received in the Commission's closure work.

The Commission addressed relevant issues and applied appropriate corrections, except in the case of the largest error

45 We reviewed the Commission's work on 27 closure packages for OPs with FISMs. The work was thorough and the Commission always addressed the FISM expenditure component, identifying areas for further inquiry, requesting clarifications and analysing responses. Open points were closed one by one, often after extensive interaction with programme authorities.

46 In many cases, the Commission made formal observations requiring clarifications or assurance. It requested additional work from the audit authorities where there were scope limitations or other open points in the programme authorities' work.

47 In addition to desk review work, the Commission performed a number of closure-related audits on FISM expenditure. These audits concerned OPs representing almost 10 % of total FISM expenditure.

48 During the 2007-2013 programming period, we recommended multiple times that the Commission pay particular attention at closure to financial instruments, as an area with a high risk of ineligible expenditure, since there were hardly any audit authority checks on the eligibility of investments during implementation[31]. We noted that the risk was highest for guarantee funds as the use of an artificially low multiplier could lead to overstated eligible expenditure[32].

49 The Commission followed our recommendations and in particular it looked closely at the guarantee fund multiplier issue. When it became aware that one Member State decided to calculate the multiplier using an approach other than that prescribed in the guidance, it directed its auditors to look closely at this in their closure work.

50 As a result of the closure work, by the end of 2020 the Commission intended to apply more than €270 million in corrections concerning FISM eligible expenditure in 29 OPs. Not all of these have been finalised. Once finalised, the corrections exclude the expenditure from the instrument and their cost is borne by the Member State. ***Table 7*** presents the corrections applied or proposed by DG REGIO by the end of 2020 on FISM

[31] See ***Annex I***.

[32] ECA 2016 Annual Report, Chapter 6, Recommendation 1.

expenditure at closure and ***Table 8*** presents a comparison to corrections applied by DG REGIO on all expenditure at closure.

Table 7 – DG REGIO[1] corrections on FISMs at closure – situation at the end of 2020 (in million euros)

Correction Type	Amount	No of OPs affected
Incorrect multiplier used for guarantee funds	200.4	5
Errors in final payment claim	31.0	2
Ineligible interest	19.5	2
Errors in selecting financial intermediaries	5.3	2
Ineligible interest subsidies and guarantee fees	2.0	1
Ineligible disbursements	1.6	1
Other corrections (adjustments and miscellaneous)	11.3	16
Total	**271.1**	

[1] DG EMPL did not apply any corrections to ESF FISMs by the end of 2020, however ESF FISMs only represent 5 % of total FISM expenditure.

Source: ECA review of closure packages and Commission data.

Table 8 – DG REGIO correction comparison – situation at the end of 2020 (in million euros)

	Amount
Declared expenditure (all OP sources)	362 231.6
Commission corrections	4 274.5
Percentage	1.18 %
Declared expenditure – FISM only (all OP sources)	14 828.5
Commission corrections – FISM only	271.1
Percentage	1.83 %

Source: ECA based on Commission data.

51 The Commission applied the corrections resulting from the findings with financial impact from our statement of assurance audits of FISMs at closure (see ***Table 3***) except one. The notable exception was the finding with the biggest financial impact. ***Box 3*** below provides a detailed look at this material error.

Box 3

Commission did not apply correction for our main finding (financial impact €139 million)

Due to a material error in one FISM in Spain, the residual risk of error for the OP rose above the 2 % materiality threshold. In our 2017 annual report, we calculated the financial impact at €139 million.

- Under the general regulation, financial instruments for enterprises **must primarily finance SMEs** in order to be eligible.
- Common sense and logic dictate that the legislator's intention was for the **majority of the euro value** of the funds to be disbursed to SMEs (the managing authority originally shared this view in 2010).
- The financial instrument concerned invested **almost 80 %** of total approved loans (by value) in companies that were **not SMEs**.

Spain and the Commission argued that the term "primarily" could also be interpreted to mean the majority of loans by number, rather than by value. We did not accept this argument, which could be taken to extremes as illustrated by the hypothetical case below:

> A fund required by law to finance primarily SMEs disburses €100 million via 10 loans. Eight of the 10 loans go to SMEs, for a total value of €10 million. Two of the 10 loans go to large companies, for a total value of €90 million.

Applying the argument put forward by Spain and the Commission, the entire €100 million would be considered as eligible expenditure invested primarily in SMEs, even though SMEs would actually receive just €10 million (10 % of the total).

Final Summary of data report and Commission assessment

Final Summary of data report does not present final data due to early publication

52 In response to a recommendation in our 2010 Annual Report, the Commission amended the general regulation in 2011 by introducing an annual reporting obligation for FISMs[33]. As a result, the Commission has produced an annual Summary of data report, presenting an overview of FISM implementation progress with both aggregated and by-country data. It served as a monitoring tool for tracking and assessing performance.

53 In its sixth and final version for 2007-2013, the report presents the data entered into the Commission's system by the managing authorities at 31 March 2017[34]. The data is presented for information purposes only, as the verification and certification of eligible expenditure is a separate, lengthier process undertaken through the analysis and ultimate approval of the closure packages, as seen above. The data submitted by the managing authorities and then compiled by the Commission for this report is also not subject to verification by the audit authorities.

54 The Commission itself makes this distinction in both the executive summary and the conclusion to the final Summary of data report and specifies that work remains to be performed during the closure process:

- "This final summary does not constitute a confirmation of eligibility at closure of the amounts reported by 31 March 2017: Managing and audit authorities will need to review these amounts during the closure process […]".

55 As required by the general regulation[35], the final Summary of data report presented implementation data as at March 2017, which was preliminary. The Commission did not publish updates of this report based on subsequent closure work. It published an updated table in DG REGIO's 2018 and 2019 annual reports, showing FISM expenditure by OP with the Commission's intended corrections (see paragraph ***60*** below).

56 The decrease from the €16.1 billion in FISM expenditure suggested by the final Summary of data report in 2017 to the current figure of €15.4 billion highlights the result of the closure work performed after 31 March 2017 by the programme

[33] Regulation (EU) No 1310/2011 of the European Parliament and of the Council (OJ L 337, 20.12.2011).

[34] Summary of data on the progress made in financing and implementing financial engineering instruments, Programming period 2007-2013, Situation as at 31 March 2017 (at closure), (EGESIF 17-0014-00, 20.09.2017).

[35] Article 67 of Regulation (EC) No 1083/2006.

authorities and the Commission. ***Table 9*** shows the €730 million change (5 %) between the preliminary and current data.

Table 9 – Final FISM expenditure comparison (in million euros)

	FISM expenditure – Final Summary of Data report 31 March 2017	FISM eligible expenditure – EC Data end 2020 (with corrections)[1]
ERDF	15 245	14 557
ESF	837	795
Total	**16 082**	**15 352** (5 % decrease)

[1] Commission applied or proposed corrections reduce the amount from €15.62 (see ***Table 6***) to €15.35 billion.

Source: ECA based on Commission data and Summary of data report as at 31 March 2017.

Reliability of the data has improved

57 We reviewed the reliability of the data in the final Summary of data report. There have been improvements in data completeness and reliability compared to previous versions of the report due to the Commission's efforts:

- Closure guidance for Member States provided a detailed reporting template and clear instructions in response to questions from managing authorities.
- Most of the information requested from the programme authorities was made mandatory for the final report.
- The Commission issued a note to its geographical unit desk officers providing instructions on checking the reliability of the data received.

58 Through these actions the Commission addressed most of the concerns identified in previous analyses of the report[36]. To substantiate this, in our statement of assurance audits of FISMs at closure we identified only one case of incorrect reporting, whereas in our audits during the implementation phase these findings were more prevalent[37].

[36] (1) DG REGIO "Financial Instruments for enterprise support, Ex post evaluation of Cohesion Policy programmes 2007-2013", February 2016 and (2) ECA special report 19/2016, "Implementing the EU budget through financial instruments".

[37] ECA Annual Reports 2014-2016, paragraphs 6.51, 6.43 and 6.25 respectively: 5 out of 7, 4 out of 7, and 4 out of 12 audited FISMs respectively had reporting issues.

59 The Commission acknowledges some of the remaining issues and provides a detailed summary. The remaining noteworthy issue identified by the Commission is that only 81 % of FISMs (by expenditure amount) reported their management costs and fees despite this being a mandatory field. This is nonetheless an improvement over the 64 % coverage in the previous report. ***Box 4*** presents a selection of the relevant data quality issues highlighted by the Commission in the report, followed by our findings from this audit.

Box 4

Selection of relevant issues identified by the Commission's data quality check

- completeness of mandatory management cost and fee data;
- disbursements to final recipients not reported in a few cases;
- interest and revolving amounts sometimes reported incorrectly;
- data combined and not provided at a specific fund level in a few cases;
- implausible output indicator figures (number of final recipients or jobs created) in some cases.

Additional data encoding and completeness issues identified by this audit

- encoding errors in the billions of euro regarding management costs for around 50 FISMs (mostly with small OP contributions) – but corrected in the totals;
- amount contributed from holding fund to specific funds not shown in a few cases.

60 In addition to the Summary of data report, DG REGIO included a table in its 2018 and 2019 Annual Activity Reports showing FISM expenditure by OP with the Commission's corrections[38]. For one operational programme, the report shows €4.2 billion more than the actual FISM expenditure declared at closure. This was a clerical error in the report and had no impact on the amount to be paid at closure, but as a result, the amount of ERDF FISM expenditure presented was €19 billion instead of €14.8 billion (overstated by 28 %).

Commission assessment of final implementation data did not provide useful information on two key indicators

61 The final Summary of data report also provides the Commission's final analysis on FISM performance (see ***Table 10***).

[38] DG REGIO 2018 and 2019 Annual Activity Reports, Annexes 10F and 10H respectively.

Table 10 – Four key indicators of FISM performance analysed by the Commission

Disbursement rates	Management fees
Rates provided at EU level and by Member State. Rates can also be calculated by thematic area (enterprises, urban development, etc.) and for each individual fund. Overall rates by product type (loans, guarantees, equity) not provided. Analysis covers evolution of disbursement rate and information on outliers with low and high disbursement rates. EU level disbursement rate: 93 %. Large variations, from 60 % in Spain to full disbursement in four Member States.	Data available at EU level and by Member State, individual fund, thematic area and product type. Analysis covers management costs and fees rate for the period and annual average, compliance with regulatory thresholds, comparison by product type and holding fund versus specific fund. EU level management costs and fees rate: the rate for the period was 6.7 % of OP contributions to FISMs and 9.1 % of FISM investments in final recipients; the average annual rate was 1.26 % of OP contributions to FISMs.
Leverage	**Reuse of funds / revolving effect**
Limited data available on leverage as not mandated by the regulation for the 2007-2013 programming period. Commission requested the information as optional. Analysis in report is based on very limited data obtained and includes discussion of impacts on leverage potential: product type and policy intent to address suboptimal market situations. As recognized by the Commission, this limited information provided voluntarily cannot be considered representative.	Data on resources returned for use in subsequent period (legacy resources) was required from managing authorities in closure guidelines. All but one Member State provided information on resources returned/to be returned. Legacy amount available for reuse was estimated at €8.5 billion. Information on intra-period revolving effect achieved was not obtained, and therefore not analysed.

Source: ECA, based on Commission's Summary of data report as at 31 March 2017.

62 The Commission's conclusion on FISM implementation is positive. It points to:

- the steady progress made on the disbursement of funds, noting the approximate 20 % increase from 31 December 2015 to 31 March 2017 and final 93 % disbursement rate;
- the 1.26 % annual average management costs and fees below the regulatory ceiling;

- the €8.5 billion in legacy resources to be reused; and
- an increase in the number of jobs created.

63 The final Summary of data report did not provide useful information on the following two indicators:

- Leverage: As the information on leverage was optional, the data obtained was not representative. The Commission noted that based on the limited and non-representative information obtained there were significant variations between instruments on achieved leverage. We do not agree with the Commission's conclusion that "the results obtained suggest that [FISMs] […] are able to mobilise resources which are at least two times higher than the Structural Funds resources available in the programmes", as there was insufficient information to support this overall conclusion.
- Intra-period revolving effect: The Commission obtained and analysed information on the returned resources to be reused for similar purposes (legacy resources), but not on whether FISMs were able to reuse resources within the period (intra-period revolving effect). Our review of the data indicates that around 10 % of the 981 specific funds were able to reuse funds to a limited degree before closure.

64 The closure guidelines did not mandate that managing authorities provide leverage and intra-period revolving effect data for the final report. As these indicators are two of the main advantages of using financial instruments instead of grants, we consider that they were necessary to the Commission's assessment of FISM performance. ***Box 5*** presents information on leverage and revolving effect in the seven instruments we audited at closure.

Box 5

Leverage and revolving effect based on our statement of assurance audits

— Leverage: five of the seven instruments achieved some level of leverage through outside investments ranging from 30 % to 70 % of fund capital.

— Intra-period revolving effect: three of the seven instruments achieved an intra-period reuse of funds ranging from 4 % to 11 % of fund capital.

Implications of these observations for 2014–2020

Guidance was expanded and visibility improved; information on risk areas now available

65 In comparison to 2007-2013, the provisions for financial instruments in the main piece of legislation for cohesion policy have grown tenfold. In addition, there are multiple Delegated and Implementing Acts focused on particular subjects concerning financial instruments. As a result, a large equivalent of the information from the 2007-2013 guidance notes now appears in the legislation. These provisions are supplemented by 16 guidance documents on specific financial instrument topics.

66 While it is not in the scope of this audit to assess the closure guidance for the 2014-2020 programming period, our cursory review indicates that it has not yet been updated to highlight particular risks based on the errors found so far during the implementation phase by us, the Commission, and the audit authorities. We believe that it would be helpful to provide this information to the programme authorities to help them target their verification and audit work.

67 Some issues remain, for example many audit authorities still audit advances to financial instruments instead of actual expenditure, which is very likely to lead to underestimated residual error rates. The Commission accepted our recommendation on this weakness and provided guidance to audit authorities on handling advances[39]. Furthermore, there is improvement on this issue for post-2020, as under the current

[39] ECA 2016 Annual Report, Chapter 6, Recommendation 2(a).

draft legislation there will be a single advance payment (for the first instalment), with subsequent instalments to be based on actual expenditure.

Regulatory limitation of audit authorities' mandate was resolved

68 The legislation for the 2014-2020 programming period initially included similar restrictions on the audit authorities in the case of instruments managed by the EIB Group. After we identified errors related to these restrictions during the 2017 statement of assurance, we recommended that the Commission ensure the audit arrangements for financial instruments managed by the EIB Group are adequate[40]. We asked the Commission to define minimum conditions for AUP engagements to guarantee that assurance is provided.

69 As a result, the Commission amended the relevant provisions in Regulation 1303/2013[41] ("the common provisions regulation"), provided a model audit report for external auditors containing minimum requirements for providing reasonable assurance[42], and tasked audit authorities with performing system and operation audits at the level of financial intermediaries[43]. All SME Initiative programmes set up before 2 August 2018, meaning the six currently in existence, are excluded from these changes[44]. However, starting from the 2018/2019 accounting year, the EIB Group has voluntarily extended the use of "reasonable assurance" reports to all SME Initiative programmes.

70 These measures adequately address the issue. We highlight this as an effective improvement in the assurance process for financial instrument expenditure.

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[40] ECA 2017 Annual Report, Chapter 6, Recommendation 1.

[41] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 (OJ L 347, 20.12.2013, p. 320).

[42] In line with IFAC's International Standard on Assurance Engagements (ISAE) 3000.

[43] Article 40 of Regulation (EU) No 1303/2013, as amended by the Omnibus Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council (OJ L 193, 30.7.2018, p. 1) and Commission Implementing Regulation (EU) 2019/1140 of 3 July 2019 (OJ L 180, 4.7.2019, p. 15).

[44] ECA 2018 Annual Report, paragraph 6.38.

Most weaknesses we identified in the audit authorities' work have been addressed in the Commission's guidance for 2014-2020

71 For the 2014-2020 programming period, the Commission provided guidance addressing most of the weaknesses we found in the audit authorities' work[45] (see paragraphs ***33*** to ***39***). It requires audit authorities to provide the following information specifically for financial instruments in their Annual Control Reports:

- thematic audit information with several suggested subject areas and an explanation if the audits were not performed;
- description of specific deficiencies detected during system audits and follow-up remedial action undertaken;
- work carried out and specific description of the irregularities identified, including corrective measures;
- the assurance on instruments implemented by the EIB Group or other international financial institutions;
- verifications that the new rules on instalment payments to financial instruments are respected;
- approach to stratification for sub-populations like financial instruments.

72 In 2018, for the first time, audit authorities reported irregularities they found in their audit of operations for the 2016-2017 Annual Control Report following a common typology agreed and shared between the Commission and Member States. The typology includes 16 sub-categories for financial instrument errors. The guidance also specifies that audit authorities should verify within the audited sample that the amounts of programme contributions paid to financial instruments are supported by the information available from managing and certifying authorities, and should also verify the audit trail.

73 Aiming to address the remaining weaknesses in the audit authorities' work, a working group comprising representatives from the Commission and audit authorities presented a "Reflection Paper on Audit Documentation" at a technical meeting in December 2019. The document provides guidance on audit documentation and audit trail practices for auditors when completing checklists and documenting their work

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[45] Guidance for Member States (EGESIF 15-0002-04, 19.12.2018) and Guidance for Member States on Audit of Accounts (EGESIF 15-0016-02, 05.02.2016).

with references to the regulatory framework and international audit standards. This guidance also applies to financial instrument audits.

Issues on eligibility of instruments for SMEs are less likely to occur

74 The situation we encountered where a financial instrument required to assist primarily SMEs disbursed most of the funds to large companies is less likely to occur in the 2014-2020 programming period. The legislation has introduced SME Initiative funds, which are financial instruments dedicated solely to SME financing. The thematic scope of financial instruments was also extended allowing for support to non-SMEs in areas of research and development, energy efficiency and other sectors.

Uncertainties may impact effective closure of financial instruments

75 For the 2014-2020 programming period, despite an annual acceptance of accounts, issues of legality and regularity can only be addressed later in the period through annual and multiannual conformity audits. We referred in our 2018 Annual Report to the ambiguity regarding the audit authorities' mandate for the closure of the 2014-2020 programming period[46].

76 For the closure of 2014-2020 OPs, the common provisions regulation requires Member States to submit a final report on the implementation of each OP without specifying the exact content and submission date[47], as it does for the annual implementation reports[48]. Most provisions concerning the closure of 2014-2020 programmes delay the final assessment of the eligibility of the costs declared for some operations, including financial instruments, until a later stage, usually at closure[49]. For financial instruments, audit authorities may audit a part of the disbursed expenditure before closure based on the requirements of the legislation for unlocking the second and subsequent instalment payments to the instrument[50].

77 Unlike the assessment of annual accounts, the common provisions regulation does not sufficiently define the role of programme authorities in the closure process. It

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[46] ECA 2018 Annual Report, paragraphs 6.68 to 6.70.

[47] Articles 50 and 141 of Regulation (EU) No 1303/2013.

[48] Article 138 of Regulation (EU) No 1303/2013 and Article 63(7) of the Financial Regulation.

[49] Articles 139(5) and 145(7) of Regulation (EU) No 1303/2013.

[50] Article 41(1)(c) of Regulation (EU) No 1303/2013.

also does not specify the work required to reassess and adjust the impact of possible ineligible costs on the residual rates for the years in question. Currently, there is no explicit regulatory requirement either for the Member States to submit a final set of accounts for the period at closure or for the audit authorities to provide assurance on total expenditure for the period, as required in the 2007-2013 final control report[51]. It is also unclear in the regulation if the last set of annual accounts should include, in one form or another, the final assessment of the eligibility at closure of the amounts disbursed for financial instruments. There is consequently a risk that, where the legislation delays assessment until closure, the audit work performed to ensure the final eligibility of expenditure will be insufficient or non-existent.

78 In our view, this legislative uncertainty may affect the Member States' capacity to carry out the necessary checks, as the document retention period may expire if some tasks are left to be performed after the end of the last accounting year (30 June 2024).

79 In our 2018 annual report we recommended that the Commission clarify these aspects in due time (and no later than December 2022) so that Member States understand what the Commission expects them to do for the closure of 2014-2020 programmes[52]. To date, the Commission has addressed a part of the recommendation. In 2019 it produced a financial instrument audit methodology package, which includes instructions to the audit authorities for obtaining assurance on the eligibility of total expenditure at closure. This audit methodology is currently being updated. The Commission is also finalising the drafting of closure guidelines, including for financial instruments. Both the updated methodology and the closure guidelines are due for release in 2021.

Data reliability efforts continue and additional data on leverage and reuse of funds allows for better assessment

80 For the 2014-2020 programming period improvements in reporting on financial instruments were included directly in the legislation[53]. We note the following improvements:

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[51] Article 62 of Regulation (EC) No 1083/2006.

[52] ECA 2018 Annual Report, Chapter 6, Recommendation 6.3.

[53] Article 46 of Regulation (EU) No 1303/2013 and Annex I of Commission Implementing Regulation (EU) No 821/2014 of 28 July 2014 (OJ L 223, 29.7.2014, p. 7).

- Member States are now required to report on the implementation of financial instruments to the Commission as part of their annual implementation report.

- The model provided for reporting on financial instruments has been discussed with managing authorities and online reporting training was made available, giving the parties responsible for entering the data in the system a better understanding of ways to improve reliability. The programme authorities' lack of familiarity with the reporting system was one of the reasons for data reliability issues in 2007-2013.

- The model provided for reporting on financial instruments includes fields for public and/or private contributions at all levels. This makes it possible to properly assess the level of leverage achieved, and indeed the latest 2014-2020 report contains a detailed leverage analysis.

- The report provides detailed information on resources returned from investments and their reuse (intra-period revolving effect).

81 However the Commission notes in its Summaries of data report as at 31 December 2018 that some gaps and inconsistencies remain in the data and that there is still room to improve data quality. This is partly because the report has evolved and requests more information from the programme authorities. We note that these issues are relatively minor and that they are being addressed.

82 One aspect of the Summaries of data report that cannot be improved is that it does not provide confirmation of eligible expenditure amounts. As it is published within a year after the relevant period ends, there is no time for the audit authorities to audit the data, let alone for adjustments and corrections from the final closure process for the period to be included. The report therefore retains its preliminary nature by design.

Conclusions and recommendations

83 Our overall conclusion is that the Member States and the Commission had largely taken the necessary steps to verify the eligibility of FISM expenditure at closure. The Commission and the national audit authorities had carried out checks, and these had yielded results. However, some errors remained undetected and the Commission had not addressed the most important error, which materially affected the closure of the OP concerned.

Commission guidance for 2007–2013 was mainly appropriate; closure provisions in the 2014–2020 legislative framework should be clarified

84 One key ingredient for a successful closure exercise is the strength of the regulatory provisions and available guidance. Given the very limited 2007-2013 FISMs provisions in the legislation, the quality of the guidance was even more important (paragraph ***15***).

85 Our conclusion is that the Commission provided the required FISM closure guidance in time and in sufficient detail. The quality of the guidance was instrumental to the programme authorities' work. It addressed most of the areas in which we found deficiencies during the implementation phase (paragraphs ***16*** to ***20***). However, it did not address the evaluation of final recipients' SME status as a particular risk, even though this was an eligibility criterion for most instruments. We identified errors on this point in our audits (paragraph ***21***).

86 For 2014-2020, most financial instrument guidance was incorporated in the legislation and additional support was provided via an extensive number of notes organized by topic. However, some issues remain problematic, namely the approach taken by some audit authorities of auditing advances to financial instruments, instead of actual expenditure (paragraphs ***65*** to ***67***).

87 Despite the improvement in the overall guidance for financial instruments, we consider that the 2014-2020 legislative provisions for closure are weaker than those for 2007-2013 in one respect. The common provisions regulation is insufficiently clear on the role of programme authorities in the closure process. It also does not specify the work needed to reassess and, if necessary, adjust the impact of possible ineligible costs on the residual rates for the years in question. There is no explicit requirement for the audit authorities to provide assurance on total expenditure for the period as for the 2007-2013 period. This is particularly relevant for financial instruments where the eligibility of a material part of the expenditure may only be assessed at closure (paragraphs *75* to *78*).

88 We recommended clarifying this issue in our 2018 annual report and the Commission has made progress in addressing it. In 2019 it provided instructions to the audit authorities for obtaining assurance on the eligibility of financial instrument expenditure at closure. The Commission is currently updating these instructions and is also finalising guidelines so that Member States understand what is expected from them at closure (paragraph *79*).

Recommendation 1 – Provide guidance targeting risk areas identified in Commission and ECA audits

In order to be optimally prepared for the upcoming closure of the 2014-2020 period, the Commission should supplement current guidance for financial instruments under shared management with specific advice to the Member States based on the most frequent errors uncovered in Commission and ECA audits.

Timeframe: By the end of 2021.

Recommendation 2 – Complete the necessary guidance on the role and responsibilities of audit authorities when assessing the eligibility of financial instrument expenditure at closure

In its updated audit methodology and upcoming closure guidelines, the Commission should provide audit authorities with the necessary instructions for providing assurance on the eligibility of financial instrument expenditure at closure. The Commission should also actively encourage audit authorities to observe this guidance in complement to the legislation, with a view to achieving a more rigorous closure.

Timeframe: By the end of 2022.

The audit authorities performed most of the necessary verifications but some errors remained undetected, sometimes leading to the inclusion of ineligible expenditure

89 The 15-month extension of the eligibility period for disbursements allowed an estimated additional €2.6 billion to reach final recipients, representing an increase in the disbursement rate from 75 % to 93 % for the 2007-2013 programming period (paragraphs *26* to *27*). However, it also created issues for the audit authorities, who were often unable to capture all FISM expenditure in their audits before closure. This resulted in scope limitations and additional work after 31 March 2017 to complete the remaining verifications (paragraphs *28* to *31*).

90 The audit authorities' work was also affected by a limitation on their mandate to audit the holding funds of instruments managed by the EIB Group. In these cases, most audit authorities did not carry out their work at any level and relied only on the work of the EIB Group's external independent auditor, which was limited in scope and could not provide any assurance on the eligibility of expenditure disbursed by the financial instrument (paragraphs *22* to *25*).

91 The same limitation was present at the start of the 2014-2020 programming period. The errors we identified in our audits and our resulting recommendation led to legislative changes, and the situation has mainly been rectified. The scope of the external auditor's work has been expanded to provide assurance and the EIB Group has voluntarily committed to applying the new rules in the cases not covered by the legislation (paragraphs *68* to *70*).

92 In general the audit authorities performed the necessary work to verify the eligibility of FISM expenditure at closure, covering the entire population and addressing the relevant issues. The main weaknesses we noted were (paragraphs *32* to *40*):

- improper documentation of the audit work;
- the extent to which certain eligibility checks were completed in high-risk areas like SME status and public procurement;
- inconsistent detail on the work performed requiring extensive follow-up by the Commission to clarify;
- thematic audits were not systematically performed or not performed near/at closure; and
- some errors went undetected, as shown by the errors uncovered by the Commission and ECA.

93 For 2014-2020, some of these weaknesses were addressed by the extensive provisions in the legislation and Commission guidance. To address the remaining weaknesses, a document produced in late 2019 by representatives from the

Commission and audit authorities provides guidance on audit documentation and audit trail issues that also apply to financial instrument audits (paragraphs ***71*** to ***73***).

The Commission addressed relevant issues and applied appropriate corrections, except in the case of the largest error

94 The Commission reviewed all closure packages in detail and systematically performed additional checks to verify the eligibility of FISM expenditure (paragraphs ***41*** to ***44***). This work resulted in formal observations to the programme authorities requiring assurance, clarification or additional work. High-risk areas such as the application of the correct multiplier to guarantee fund expenditure were closely monitored and appropriate corrections were applied (paragraphs ***45*** to ***50***).

95 In general the Commission detected ineligible expenditure and addressed findings through its closure work. However, it rejected the most material finding that resulted from one of our audits. The Commission accepted the eligibility of a FISM that invested almost 80 % of the approved total value of loans in companies that were not SMEs, although the legislation specified that to be eligible the financial instrument should primarily finance SMEs (paragraph ***51***). This situation is less likely to occur in 2014-2020, as the legislation has introduced financial instruments dedicated solely to SME financing. The thematic scope of financial instruments was also extended allowing for support to non-SMEs (paragraph ***74***).

Reporting reliability improved over the years, but the data in the final implementation report was not final and lack of information on two important indicators led to an incomplete assessment

96 The Commission's final report for 2007-2013 presents the data entered into the reporting system by managing authorities by 31 March 2017 as required by the legislation. This was preliminary data without the adjustments and corrections of subsequent closure work which resulted in a reduction of eligible FISM expenditure of €730 million (5 %). Although this approach may appear reasonable as the report is intended for timely use by the various stakeholders assessing the success of FISMs, in the absence of a legal requirement the Commission did not update the report in order to provide final data (paragraphs ***52*** to ***56***).

97 The final report represented an improvement over previous versions in terms of data reliability. This was due to the efforts made by the Commission in its reporting guidance and its own data quality work (paragraphs ***57*** and ***58***). Nonetheless, as the

Commission acknowledges in the report, some reliability issues persisted (paragraphs ***59*** to ***60***).

98 The Commission provided a positive assessment of FISM implementation, pointing to several factors such as the 93 % final disbursement rate, average management costs below the regulatory ceiling and €8.5 billion in legacy resources (paragraphs ***61*** and ***62***). Based on the limited and non-representative information obtained on the ability of FISMs to attract additional investment and on intra-period reuse of funds, we consider that there is a gap in the assessment considering that these are two of the main advantages of using financial instruments rather than grants. Therefore, the Commission's conclusion that "the results obtained suggest that [FISMs] […] are able to mobilise resources which are at least two times higher than the Structural Funds resources available in the programmes" is not supported by sufficient evidence (paragraphs ***63*** and ***64***).

99 For 2014-2020, there are notable improvements in the design of the reporting, including more extensive reporting on management costs and fees and the inclusion of analyses on leverage and intra-period reuse of funds. The remaining reliability of data issues are relatively minor and are being addressed. However, as the report is published within a year after the relevant period ends, it retains its preliminary nature by design (paragraphs ***80*** to ***82***).

This Report was adopted by Chamber II, headed by Mrs Iliana Ivanova, Member of the Court of Auditors, in Luxembourg on 17 March 2021.

For the Court of Auditors

Klaus-Heiner Lehne
President

Annexes

Annex I – ECA reports highlighting the importance of FISM verification work at closure

A. **2015 Annual Report** – We recommended (Chapter 6, Recommendation 5) that the Commission ensure that all expenditure related to 2007-2013 FISMs is included sufficiently early in the closure declarations to enable audit authorities to carry out their checks.

B. **2016 Annual Report** – We stated that the errors identified in the Commission's implementation report had the effect of overstating performance and, if not corrected, of artificially increasing the declared amount of eligible expenditure at closure, especially in the case of guarantee funds. We therefore recommended that the Commission pay particular attention to this at closure (paragraphs 6.25 and 6.41 – Recommendation 1(a)).

C. **2017 Annual Report** – We noted that the Commission recommended that audit authorities perform "thematic" audits for financial instruments in order to provide assurance at closure that the amounts paid to final recipients were used as intended. We found that not all audit authorities systematically performed these audits and that where they did, the work was not always sufficient to identify material irregularities (paragraphs 6.34 and 6.35).

D. **2018 Annual Report** – We stated that, despite substantial efforts by the Commission to improve data quality at closure, we still found inaccuracies in the closure implementation report based on one of our audits in this year (paragraph 6.35).

E. **SR 2/2012**[54] – In this special report we noted that the Commission would only be able to regularise the oversized fund endowments at closure (paragraph 56).

[54] Special report 02/2012, "Financial Instruments for SMEs co-financed by the European Regional Development Fund".

F. **SR 19/2016**[55] – In this special report we reiterated that the Commission could only determine the total eligible expenditure at closure (Box 1, page 30).

G. **SR 36/2016**[56] – In this special report we determined that for FISMs in particular there is a risk of ineligible expenditure being declared at closure and noted that the Commission also identified this as a risk area and provided guidance to audit authorities (paragraphs 107, 113 and 141). We recommended that the Commission ensure that Member States implement specific procedures to verify the eligibility of expenditure relating to financial instruments (Recommendation 7).

H. **SR 17/2018**[57] – In this special report we found a number of inconsistent and inaccurate figures in the final implementation report for 2007-2013 FISMs. We noted that, as the closure process was still on-going, the Commission was in a position to verify the reliability of the figures used to close the OPs (paragraph 72).

[55] Special report 19/2016, "Implementing the EU budget through financial instruments — lessons to be learnt from the 2007-2013 programme period".

[56] Special report 36/2016, "An assessment of the arrangements for closure of the 2007-2013 cohesion and rural development programmes".

[57] Special report 17/2018, "Commission's and Member States' actions in the last years of the 2007-2013 programmes tackled low absorption but had insufficient focus on results".

Acronyms and abbreviations

DG EMPL: Directorate-General for Employment, Social Affairs and Inclusion

DG REGIO: Directorate-General for Regional and Urban Policy

ERDF: European Regional Development Fund

ESF: European Social Fund

FISM: Financial instruments under shared management

OP: Operational programme

SME: Small or medium-sized enterprise

Glossary

Audit authority: An independent entity in the Member State responsible for auditing the systems and operations of an EU spending programme.

Certifying authority: A body designated by a Member State to certify the accuracy and conformity of statements of expenditure and requests for payment.

Closure: The financial settlement of an EU programme or fund, through payment of the balance due to, or the recovery of funds from, a Member State or other beneficiary country.

Cohesion policy: The EU policy which aims to reduce economic and social disparities between regions and Member States by promoting job creation, business competitiveness, economic growth, sustainable development, and cross-border and interregional cooperation.

Common provisions regulation: The regulation setting out the rules that apply to all five of the European Structural and Investment Funds.

EIB Group: European Investment Bank and European Investment Fund.

European Regional Development Fund: An EU fund that strengthens economic and social cohesion in the EU by financing investments that reduce imbalances between regions.

European Social Fund: An EU fund for creating educational and employment opportunities and improving the situation of people at risk of poverty.

Final control report: Part of the closure package, submitted by audit authorities at closure.

Final implementation report: Part of the closure package, submitted by managing authorities at closure.

Financial instrument: Financial support from the EU budget in the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments.

General regulation: The rules governing the European Regional Development Fund, the European Social Fund and the Cohesion Fund for the 2007-2013 programming period, superseded for the following period by the common provisions regulation.

Managing authority: The national, regional or local authority (public or private) designated by a Member State to manage an EU-funded programme.

Shared management: A method of spending the EU budget in which, in contrast to direct management, the Commission delegates to the Member State while retaining ultimate responsibility.

Statement of assurance: A statement published in the ECA's annual report, setting out its audit opinion on the reliability of the EU accounts and the regularity of the transactions which underlie them.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS SPECIAL REPORT: "FINANCIAL INSTRUMENTS IN COHESION POLICY AT CLOSURE OF THE 2007-2013 PERIOD: VERIFICATION WORK YIELDED GOOD RESULTS OVERALL, BUT SOME ERRORS REMAINED"

EXECUTIVE SUMMARY

I. Financial instruments play a significant role in delivering the cohesion policy objectives. In 2007-2013 this delivery tool was implemented in nearly all Member States. Many important lessons were learnt during the implementation and the closure of the programmes with financial instruments. To facilitate a greater uptake of financial instruments, in 2014-2020 the legislative framework was significantly improved by providing clear provisions and a greater legal certainty for the Member States. Both the Member States and the Commission take the necessary steps to achieve assurance that the expenditure are verified and are legal and regular throughout the programme implementation and at closure. Reporting requirements also improved by covering a more extensive scope of data and actions taken to help the Member States to submit more accurate and reliable data. The Commission continues to work on the audit methodology taking into account the experience from the audits carried on the financial instruments in the 2014-2020 programmes. The importance of verification by the audit authorities at closure is also emphasised in the upcoming guidance on closure. As a result we expect that the legislative framework as well as the audit methodology and guidelines for closure constitute an adequate basis for ensuring the necessary assurance to close the 2014-2020 programmes.

V. While support to SMEs is important, as stated in our reply to the chapter 6 of the ECA annual report 2017, Article 44 of Regulation (EC) No 1083/2006 does not preclude loans to be given also to large enterprises if all other conditions are fulfilled. Since no minimum level of funding to SMEs is mentioned in this provision, the term 'primarily' could also be interpreted as referring to the number of individual loans (and not necessarily to amounts).

IX. Even though data on the leverage and intra-period reuse of funds (revolving effect) was not reported for all FISM, the Commission issued the final report in line with the underlying legal basis and the collection of such information in the new generation of financial instruments will enable enhanced reporting scope in the future.

X.

First indent: The Commission accepts the recommendation. The Commission will update the audit methodology for FISMs which will be shared with both audit and managing authorities.

Second indent: The Commission accepts the recommendation. The Commission will update the audit methodology for FISMs, strengthening the aspects on closure which will be shared with both audit and managing authorities. Furthermore, specific audit aspects on FISM closure are being dealt with in the draft closure guidance.

OBSERVATIONS

08. The Commission audit services have developed an audit methodology for financial instruments and performed audits, both on the set-up and the implementation of FIs. Furthermore, audit authorities have also performed both system audits and audits of operations on FISM, mainly at closure.

21. At the moment of the investment decision, the bodies implementing the FISM should verify the eligibility of the final recipients in line with the signed funding agreements.

Based on its own audit results, ECA findings and experience from national audits, the Commission discussed the topic of how and when to assess the SME status of a beneficiary or final recipient with the audit authorities at a technical meeting in 2019 (6 December 2019). The Commission provided to the audit authorities information on how to assess the SME status, including a self-assessment tool. The self-assessment tool could be used by the final recipients when declaring their status in the application for the loan or equity investments.

24. Restrictions on audit authorities accessing information held by the EIB Group did not prevent them from carrying out their own audit work or from verifying the eligibility of the expenditure disbursed by the financial instrument. The Commission notes that such audits have been carried out in Bulgaria and Lithuania.

26. The Commission has acted in line with the European Council's recommendations of December 2014 and within the margin offered by the existing regulatory framework with respect to the eligibility period.

28. <u>Common Commission reply to paragraphs 28 to 31:</u>

The audit authorities performed additional work after 31 March 2017 in order to obtain the necessary assurance for the closure of the programmes.

37. As regards the ECA comment on individual authorities' work which is considered insufficient, see Commission's reply to Box 3.

50. At the date of the publication of this report, the Commission is still working on the closure of the remaining programmes with FISM. The amount of corrections indicated by the ECA may still be revised based on additional information obtained from Member States.

Box 3 - As stated in our reply to chapter 6 of the ECA annual report 2017, Article 44 of Regulation (EC) No 1083/2006 does not preclude loans to be given also to large enterprises if all other conditions are fulfilled. Since no minimum level of funding to SMEs is mentioned in this provision, the term 'primarily' could also be interpreted as referring to the number of individual loans (and not necessarily to amounts).

63. First indent: The source of the information was the data for those instruments that reported the information and where the Commission could do the calculation and make conclusions. Therefore we wrote that "the results suggest" but they are not representative, because those financial instruments for which such usable information was reported were not many as it was not required by legislative framework applicable to the 2007 – 2013 programming period.

64. The summary of data provided the information on the basis of the applicable legal framework for 2007-2013. Due to the elements indicated by the ECA in its reports during the years, the legal requirements for reporting on FISMs for 2014-2020 programming period were considerably improved.

66. The Commission will update the audit methodology for FISMs which will be shared with both audit authorities (through technical meetings) and managing authorities (through EGESIF).

67. In line with Article 137 of Regulation (EU) No 1303/2013, programme accounts are based on the amounts declared to the Commission, including advance payments to financial instruments. Audit authorities provide residual error rates based on the expenditure included in the accounts. To constructively follow up on the ECA's 2016 recommendation, audit authorities agreed to provide the Commission with additional detailed information allowing it to calculate in the Annual Activity

Reports residual error rates excluding the impact of advances paid into financial instruments as also acknowledged in the ECA's 2019 annual report.

The guidance already provided to the audit authorities on the treatment of advances with the audit methodology from 2019 is being further updated and will be shared in 2021.

76. The approach on annual acceptance of accounts is designed to anticipate the verification of the eligibility of expenditure (notwithstanding advance payments) entered into the annual accounts submitted throughout the implementation period, while part of the last advance for financial instruments will have to be audited at closure against implementation.

The Commission interprets that the date for submission of the closure documents is covered in Article 138 CPR, i.e. 15 February 2025 (up to 1 March 2025 on a Member State's request) which corresponds to the last accounting year of the programming period (2023-2024). The content of the closure documents required under the Regulation, plus the final implementation report, is the same as for any accounting year. Some specificities of the last accounting year will be clarified in the closure guidance to be published in 2021, including provisions on the assurance on the final amounts of eligible expenditure declared at closure for financial instruments and a request for additional reporting by the audit authorities.

77. In the draft Closure guidelines 2014-2020, the section on "Audit opinion and control report" contains provisions on the assurance on the final amounts declared as eligible expenditure at closure for financial instruments, including a request for additional reporting by the AAs. The draft guidelines were presented on 20 October 2020 to the Member States and will be adopted as a Commission Decision in 2021.

Furthermore, the financial instrument audit methodology is currently being updated to provide additional clarifications concerning the assurance for the financial instrument expenditure at closure.

78. The expectations for the verifications and control for financial instruments, including at closure, are described in the financial instrument audit methodology and in the closure guidance which will be adopted as a Commission Decision in 2021.

82. The purpose of the Summaries of data is not to confirm the eligibility of expenditure as this should remain a separate process.

CONCLUSIONS AND RECOMMENDATIONS

83. With regard to the last sentence of the observation, as stated in our reply to chapter 6 of the ECA annual report 2017, Article 44 of Regulation (EC) No 1083/2006 does not preclude loans to be given also to large enterprises if all other conditions are fulfilled. Since no minimum level of funding to SMEs is mentioned in this provision, the term 'primarily' could also be interpreted as referring to the number of individual loans (and not necessarily to amounts).

85. At the moment of the investment decision, the bodies implementing the FISM should verify the eligibility of the final recipients in line with the signed funding agreements.

Based on its own audit results, ECA findings and experience from national audits, the Commission discussed the topic of how and when to assess the SME status of a beneficiary or final recipient with the audit authorities at a technical meeting in 2019 (6 December 2019). The Commission provided to the audit authorities information on how to assess the SME status, including a self-assessment tool. The self-assessment tool could be used by the final recipients when declaring their status in the application for the loan or equity investments.

86. In line with Article 137 of Regulation (EU) No 1303/2013, programme accounts are based on the amounts declared to the Commission, including advance payments to financial instruments. Audit

authorities provide residual error rates based on the expenditure included in the accounts. To constructively follow up on the 2016 ECA's recommendation, audit authorities agreed to provide to the Commission additional detailed information allowing it to calculate in the Annual Activity Reports residual error rates excluding the impact of advances paid into financial instruments as also acknowledged in the ECA's 2019 annual report.

The guidance already provided to the audit authorities on the treatment of advances with the audit methodology from 2019 is being further updated and will be shared in 2021.

87. The CPR provides a sufficient basis for the role of each actor in the Member States and of the Commission in the closure process. The Commission interprets that the date for submission of the closure documents is covered in Article 138 CPR, i.e. 15 February 2025 (up to 1 March 2025 on a Member State's request) which corresponds to the last accounting year of the programming period (2023-2024). The content of the closure documents required under the Regulation, plus the final implementation report, is the same as for any accounting year. Some specificities of the last accounting year will be clarified in the closure guidance to be published in 2021, including provisions on the assurance on the final amounts of eligible expenditure declared at closure for financial instruments and a request for additional reporting by the audit authorities.

Recommendation 1 – Provide guidance targeting risk areas identified in Commission and ECA audits

The Commission accepts the recommendation.

The Commission will update the audit methodology for FISMs which will be shared with both audit and managing authorities.

Recommendation 2 – Complete the necessary guidance on the role and responsibilities of audit authorities when assessing the eligibility of financial instrument expenditure at closure

The Commission accepts the recommendation.

The Commission will update the audit methodology for FISMs strengthening the aspects on closure which will be shared with both audit and managing authorities. Furthermore, specific audit aspects on FISM closure are being dealt with in the draft closure guidance to be issued in 2021.

95. As stated in our reply to chapter 6 of the ECA annual report 2017, Article 44 of Regulation (EC) No 1083/2006 does not preclude loans to be given also to large enterprises if all other conditions are fulfilled. Since no minimum level of funding to SMEs is mentioned in this provision, the term 'primarily' could also be interpreted as referring to the number of individual loans (and not necessarily to amounts).

Audit team

The ECA's special reports set out the results of its audits of EU policies and programmes, or of management-related topics from specific budgetary areas. The ECA selects and designs these audit tasks to be of maximum impact by considering the risks to performance or compliance, the level of income or spending involved, forthcoming developments and political and public interest.

This performance audit was carried out by Audit Chamber II Investment for cohesion, growth and inclusion spending areas, headed by ECA Member Iliana Ivanova. The audit was led by ECA Member Ladislav Balko, supported by Branislav Urbanič, Head of Private Office; Juan Ignacio Gonzalez Bastero, Principal Manager; Viorel Cirje, Head of Task; and Adrian Rosca and Borja Martin Simon, Auditors.

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Juan Ignacio Gonzalez Bastero

Adrian Rosca

Borja Martin Simon

Timeline

Event	Date
Adoption of Audit Planning Memorandum (APM) / Start of audit	1.7.2020
Official sending of draft report to Commission (or other auditee)	29.1.2021
Adoption of the final report after the adversarial procedure	17.3.2021
Commission's (or other auditee's) official replies received in all languages	26.3.2021

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Financial instruments were an important method of cohesion policy financing in the 2007-2013 programming period. Our previous audits concerning these instruments revealed a number of errors and weaknesses during implementation. The Commission stated that these shortcomings would be addressed at closure.

We found that the Commission and Member States had largely taken the necessary steps to verify the eligibility of this expenditure at closure. Although we identified some errors with financial impact, overall their work had yielded good results. While most of the shortcomings we identified have been addressed for the 2014-2020 programming period, we recommend that the Commission provide advice on the most frequent errors uncovered in audits. We further recommend that the Commission complete the guidance to audit authorities for providing assurance on the eligibility of financial instrument expenditure at closure.

ECA special report pursuant to Article 287(4), second subparagraph, TFEU.

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