



EUROPEAN COMMISSION
DIRECTORATE-GENERAL FOR REGIONAL AND URBAN POLICY
Audit
The Director

Brussels,
REGIO.DGA1.C1/BK/afb (2016)1507923

**TO THE ATTENTION OF THE AUDIT AUTHORITIES
OF ERDF, ESF, EFF AND COHESION FUND**

Subject: Advice on sampling selection concerning 2015/2016 expenditure and audit assurance at closure - Programming period 2007-2013

Dear representatives of the Audit Authorities,
Dear colleagues,

Following request for information from several audit authorities on sampling procedures concerning expenditure declared in 2015 and 2016, the audit services of the Directorates General for Regional and Urban Policy, Employment, Social Affairs and Inclusion and Maritime Affairs and Fisheries consider useful to share with you some advice on sampling issues in the context of closure of operational programmes 2007-2013. This letter also follows the discussions held in the Homologues Group Meeting of 21-22 September 2015¹ on audit assurance at closure.

1. ERROR RATE TO BE DISCLOSED FOR EXPENDITURE DECLARED IN 2015 AND 2016

The audit authorities should provide a single projected error and a single upper error limit (UEL) for the whole period of 2015 and 2016 until the closure. This projected error rate will be used to determine the need to apply corrective measures in relation to the expenditure declared in the reference period (2015-2016 until closure). This error rate will be applied in the calculation of the residual risk rate which is one element underlying the audit opinion at closure.

The audit authority could select one single sample that can be stratified by period (typically 1 or 2 periods for 2015 and 1 period for 2016). Alternatively, it could choose to have separate independent samples designed to be representative of each year (one for expenditure declared in 2015 and another for expenditure declared in 2016). In such a situation, the audit authority will have to combine two projected errors and two upper error limits in order to obtain one single total projected error rate and one single UEL for the whole period.

¹ Namely the workshop "Audit assurance at closure". The presentation is available in CIRCABC under "EC/Member States audit coordination > Library > meetings > homologue_meetings > 2015 Riga - Latvia - 21-22 September".

In case the audit authority opts for a single sampling procedure covering the period of 2015 and 2016 together, the approach based on a single multi-period sample will generally lead to a smaller combined sample size than an approach based on two independent samples. It should be stressed that even if the audit authority has already selected the sample for 2015 expenditure on the assumption to present an error rate for 2015, it can still adapt the 2016 sample to treat it as a sampling period of the combined 2015 and 2016 sample. Please also note that since 2016 expenditure shall be treated in such a case as a stratum (and not a separate population), the threshold of 50-150 sampling units in the population for statistical sampling and the requirement of 30 units in the sample do not apply individually in regard to the 2016 expenditure (but to 2015-2016 expenditure as a whole).

Annex I to this letter includes technical information in regard to the combination of error rates in the case of independent 2015 and 2016 samples, as well as in regard to adjustment of sampling procedure for application of the common 2015/2016 sample.

2. POPULATION TO BE COVERED BY THE LAST RANDOM SAMPLE

2.1. Period covered by the last sampling exercise

The error rate of the positive population of the last random sample to be provided by the audit authority at closure should be based on expenditure declared to the Commission as from 1 January 2015 until the submission of the certified statement of final expenditure.

The audit authority should agree with the managing authority and certifying authority on a date for the final declaration of the expenditure so that the audit authority can draw its sample, perform the audit of operations and conclude them in due time before 31/03/2017. As stated in footnote 23 of the Commission's guidelines on closure (Commission Decision C(2015) 2771 final of 30.4.2015), the Commission recommends the following.

*"In order to ensure that the audit authority is able to cover the expenditure declared in 2016 and in view of the deadline of 31 March 2017 for the submission of the closure declaration, it is recommended that the certifying authority submits the last interim payment claim by **30 June 2016**, at the latest, thus ensuring that after this date no new expenditure will be declared to the Commission before the submission of the final payment application."*

Thus, the national authorities should avoid having new expenditure declared after 30 June 2016, as this may hamper the audit authority's work for the closure declaration and thus possibly result in scope limitation and reservations at closure.

In case the certifying authority would not be in the position to declare all the expenditure within the deadline of 30 June 2016 (or other deadline agreed between the certifying authority and the audit authority), the expenditure declared after the date should not be excluded from the random sample. Excluding such expenditure from the random sample (including it for example instead in a complementary sample) would imply that the projected error rate is unreliable, as it does not cover the population on which the audit authority has to draw an opinion at closure. See sections 2.3 and 2.4 below for the recommended approach in such a situation.

2.2. Avoid auditing expenditure not yet declared to the Commission

The audit authority should not audit expenditure not yet declared to the Commission. As defined in the guidance on sampling methods for audit authorities (COCOF_08-0021-03_EN of 04/04/2013) and as results from Article 17 of Regulation (EC) No 1828/2006, the projected error is based on a sample of operations drawn from the expenditure declared to the Commission.

2.3. What if the certifying authority certifies new expenditure between July 2016² and March 2017?

In case the certifying authority will still certify some new expenditure between July 2016 and 31 March 2017, the audit authority will have to take into account this expenditure in its projected error rate. As clarified above, the audit authorities should provide a single projected error for the whole period of 2015 and 2016 until closure. In line with the general methodology presented in section 1 of this letter, the audit authority does not need to treat the expenditure declared between July 2016 and March 2017 as a separate population. This expenditure may be treated as an additional stratum of the population of expenditure declared from January 2015 until closure, to be added to the already existing sample. Annex I to this letter includes technical information on sampling methodology, which, by analogy, could be applied in such cases. The audit authority could decide to verify this additional stratum at random or, depending on the workload, exhaustively if the audit authority expects high error rates in the concerned expenditure. Exhaustive verification of the stratum could ensure that appropriate corrections are identified in case of high error rates in these operations, thus avoiding any increase of the Residual Error Rate (RER)³.

2.4. What if the certifying authority certifies new expenditure on 31 March 2017?

If the certifying authority declares new expenditure in the certified statement of final expenditure, to be submitted to the Commission by 31/03/2017, the audit authority would not be able to cover this expenditure in its random sample, thus leading to a possible scope limitation in the closure declaration. Therefore, the certifying authority should avoid such late declaration of new expenditure.

In this case, the audit authority will have to apply its professional judgement to assess the extent and materiality of this scope limitation and its impact on the audit opinion at closure, as results from Article 18(4) of Regulation (EC) No 1828/2006. The audit authority will need to assess whether this affects the "*reasonable assurance as to whether the payment application for the final balance (...) is correct and valid and the underlying transactions covered by the final statement of expenditure are legal and regular*" (as stipulated in the model closure declaration, Annex VIII, part B of the said Regulation). In particular, the audit authority will have to consider whether additional audit work is still required due to possible specific risks associated with that expenditure.

² Or any other cut-off date agreed with the certifying authority.

³ In case the errors would be accepted and corrected by the managing and certifying authorities. In such a case, the errors corrected in the exhaustive stratum would have an impact only on the TPER without increasing the RER. For more information on the Residual Error Rate and its impact on the audit opinion, please see *Updated Guidance for Member States on treatment of errors disclosed in the annual control reports* (EGESIF_15-0007-01 final of 09/10/2015).

For the latter case, this additional audit work would need to be performed by the audit authority after the submission of the closure declaration and within a reasonable deadline to be agreed with the Commission services. Such late certification of additional expenditure in the final statement of expenditure by the certifying authority is therefore expected to delay the programme closure process and payment of the balance by the Commission, pending the results of the additional audit work from the audit authority.

Our services remain at your disposal for any questions you may have in relation to the 2015/2016 sampling exercise. These issues will also be discussed in the bilateral co-ordination meetings with your services, to be held in first semester of 2016.

In order to better assist your services and prevent any major technical difficulty before closure, we kindly ask you to provide us with information on the ERDF/CF, ESF and EFF sampling procedures applied for the 2015 expenditure as well as the sampling strategy considered for the whole 2015-2016 period. In **Annex II** to this letter, you will find a set of data that should be sent to the respective audit services of the three Directorates General for their respective Funds; this data should be sent before the bilateral co-ordination meetings to be held in 2016 with your services, as it will serve as a basis for discussion in these meetings.

In **Annex III** to this letter, you will find the approach to be taken by audit authorities in regard to the audit assurance at closure, as discussed in the Homologues Group Meeting in Riga.

As you are aware we intend to present in the next technical meeting a final draft of the *Guidance on sampling method for audit authorities* (for the programming periods 2007-2013 and 2014-2020). This draft will take account of the comments received in the 2nd semester of 2015 and subsequently, in particular those received during the workshop of January 2016 with ETC experts from interested Member States. The final draft of the guidance will be further presented in a subsequent meeting of the EGESIF.

Yours sincerely,



Franck Sébert

Enclosures: Annex I - Clarification regarding the sampling strategy for the audit of operations in 2015 and 2016

Annex II – Information to be provided on sampling procedures for 2015/2016 expenditure

Annex III – Audit assurance at closure

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Annex I - Clarification regarding the sampling strategy for the audit of operations in 2015 and 2016

For the period 2015 and 2016 the audit authorities are required to disclose one single error rate for the population comprising the whole period of 2015 and 2016. The audit authorities are invited to revise their sampling strategy in order to accommodate the fact that only one error has to be projected for the whole period. There are two options at the disposal of the audit authorities:

- 1) either to select two separate independent samples, one for 2015 and another for 2016 and subsequently to combine the respective error rates to obtain a single projected error and a single UEL for the whole period, or
- 2) to apply an approach based on single (typically multi-period) sample, which would require adjustment of on-going sampling procedure if selection of 2015 sample has already taken place.

Considering the Commission recommendation for the certifying authority to avoid certifying new expenditure after 30 June 2016, the assumption taken here is that normally there will be only one semester of expenditure in 2016.

Option 1

The audit authority selects 2 independent samples: one for 2015 and another for 2016.

In this case, from the sampling point of view, the audit authority will have to combine 2 projected errors and 2 upper error limits in order to obtain one single projected error and one single UEL for the whole period.

As far as the projected error is concerned, the correct way to proceed is to produce a weighted average of the 2 independent error rates, using the expenditure of each year as weights. Consequently the projected error rate is

$$ER_{combined} = \frac{(BV_{2015} \cdot ER_{2015} + BV_{2016} \cdot ER_{2016})}{BV_{2015} + BV_{2016}}$$

The calculation of the UEL has to be obtained through the calculation of precision. Nevertheless, note that the precisions of the 2 different years **cannot** be directly added. Instead, the audit authority has to calculate the combined precision dealing with each year as if they were one stratum in a stratified sampling design. The exact formulas will depend on the sampling method used, but if the same sampling method is used for both years, the calculation will be simplified. For illustration purposes and considering the very much used standard MUS method, the combined precision will be:

$$SE_{combined} = z \times \sqrt{\frac{BV_{s2015}^2}{n_{s2015}} \cdot s_{rs2015}^2 + \frac{BV_{s2016}^2}{n_{s2016}} \cdot s_{rs2016}^2}$$

where s_{rst} is the standard-deviation of error rates in the sample of the non-exhaustive group of year t , BV represents the expenditures and ns the sample sizes of the non-exhaustive group.

Finally, the UEL for the combined period is obtained as usual using the formula:

$$UEL_{combined} = EE_{combined} + SE_{combined}$$

Option 2

The audit authority selects one single sample that can be stratified by period (1 or 2 periods for 2015 and 1 period for 2016).

In this case there will be one single sample that is stratified by period. Although in this specific situation there is the singularity of having one sample covering more than one year, the methodology of multi-period sampling covered in the *Guidance on sampling methods for audit authorities* is applicable. This will originate a two-period (one for 2015 and one for 2016) or three-periods audit (two for 2015 and one for 2016), depending on the fact whether the 2015 expenditure is treated as one single period or a two-period approach is applied.

The only specificity of this approach is concerned with the fact that the audit authority may have already audited the sample of the 1st period of 2015, and possibly started the audit of the 2nd period of 2015, having these samples selected with assumptions compatible with the goal of projecting the total error of the year (2015).

This means that the subsequent samples (typically the one covering the 2nd semester of 2015 and the one covering 2016, or only 2016 if 2015 sample is already selected and considered fixed) should be adapted in order to be representative of the combined time frame of 2015 plus 2016. This is easily achievable by recalculating the sample sizes of subsequent periods using new population parameters representative of the combined period of 2015 and 2016. All the formulas for this calculation are already available in the *Guidance on sampling methods for audit authorities* in the sections devoted to multi-period approaches. Again, and taking as example the standard MUS method, if the 2015 sample is already selected and considered fixed, the 2016 sample can be adapted in order to have a global sample representative of the combined period (2015 plus 2016) using the following formula:

$$n_{2016} = \frac{(z \times BV_{2016} \times \sigma_{r2016})^2}{(TE_{combined} - AE_{combined})^2 - z^2 \times \frac{BV_{2015}^2}{n_{2015}} \times s_{r2015}^2}$$

where s_{r2015} is the standard-deviation of error rates calculated from the sample of 2015 and σ_{r2016} is an estimate of the standard-deviation of error rates in 2016 based on historical knowledge, a preliminary sample or professional judgment. Also, please note that the combined anticipated error (AE) should consider the expectation for the combined error for the whole period.

If the audit authority is already using a two-period approach in 2015 and the audit work for the 2nd semester has not yet began, it may choose to revisit the sample size calculation for this period, using exactly the same approach explained above. This will, in general, reduce the sample size and audit work that is needed for the 2nd period of 2015.

It should be noted that by treating 2016 as a stratum, it is possible to apply a statistical method for the combined period, even if the 2016 population is small (below the threshold of 50-150 sampling units). Within a single stratum the rule of a minimum of 30 units sample size do not apply and it will be possible to project errors and calculate precision even if one or more strata have sample sizes bellow 30. However, a minimum of three sampling units should be checked per stratum and a recommended approach would be to increase this minimum threshold to five sampling units, if possible.

Annex II - Information to be provided on sampling procedures for 2015/2016 expenditure

1. The sampling method used/to be used for 2015 and 2016 expenditure. Confirmation should be provided that it is in accordance with the audit strategy or that an updated audit strategy has been prepared.
2. The deadline agreed between the audit authority and certifying authority concerning declaration of the last positive expenditure items to the Commission before closure.
3. Information whether the audit authority is planning to opt for 2 independent samples of 2015 and 2016 (and to disclose a combined error rate) or alternatively 2016 sample will be treated as a stratum of 2015/2016 sample.
4. The sampling unit used/to be used for 2015 and 2016 expenditure.
5. The number of sampling units in 2015 expenditure and forecasted number of sampling units in 2016 expenditure.
6. The value of the 2015 population sampled and a reconciliation of this amount to the expenditure declared by the certifying authority to the Commission in 2015. Reconciling items could include negative amounts where financial corrections have been made in 2015.
7. Forecasted value of 2016 population.
8. The materiality level.
9. The confidence level applied and the interval, if applicable.
10. Additional parameters used for sampling, such as expected error and standard deviation.

Annex III - Audit assurance at closure

At closure, there will be a need to have sufficient audit assurance for each operational programme for the purpose of the audit opinion. Article 17(5) of Regulation (EC) No 1828/2006⁴ provides for a regular review of the coverage provided by the random sample, considering in particular the need to have sufficient audit assurance for the declarations to be provided at the closure procedure.

As it was done during programme implementation, the audit assurance at closure should be built from the audit authority's work on system audits as well as on the audits of operations and any complementary audits judged necessary by the audit authority based on their risk assessment, taking into account the audit work carried out during the programming period. This means that the regular review of the coverage provided by the random sample (cf. Article 17(5)) should not be interpreted as requiring a given percentage of expenditure certified to be audited for each programme. This is in particular true when statistical sampling was consistently applied by the audit authority throughout the implementation period and periodically validated by Commission services through the assessment of ACRs. The main purpose of the provision at stake is to ensure that in view of the closure declaration the audit authority's assurance on each programme covers indeed all relevant intermediate bodies, priority axis, operations, and beneficiaries, based on all audit results obtained through system audits, audits of operations and any complementary audits.

The main issue relates to situations where the random sample covered a group of programmes included in a common management and control system, or where a common sample covers ERDF/CF and ESF programmes. When statistical sampling was correctly applied, the random sample selected each year was representative of the population year after year. The audit authority's opinion provided each year was drawn from the assurance provided by the audits of the operations selected on that basis, together with the conclusions drawn from system audits, and, where certain risks had not been covered by the random samples, through complementary samples. With this information, the audit authority should therefore be able to build a grid to analyse whether audits provided sufficient evidence that the expenditure declared is legal and regular and that any identified risks were sufficiently covered for all components of programmes.

It may be that a given priority axis was hit by the random sample only once in the beginning of the programming period or the audit authority only audited very few operations in that priority. If the audit authority has covered the same priority through system audits and no particular risks were identified, it is deemed appropriate to conclude that the audit authority has sufficient audit assurance for that axis. A similar exercise would be done for the remaining priority axes of the programme.

Another scenario is when the audit authority has used non-statistical sampling for its audits of operations for part or the whole programming period. While the representativeness of the random sample should also have been ensured each year, it may be that before closure the audit authority detects that a certain group of intermediate bodies or beneficiaries was never audited, either via system audits or audits of operations. In this case, the audit authority may conclude that a complementary sample on that group is required in 2016, to ensure sufficient audit assurance for the programme at closure.

⁴ Article 43(5) of Regulation (EC) No 498/2007.

It can also be that the audit authority considers that some risky areas / aspects were insufficiently covered over the period or that new risks appearing only at closure (financial engineering instruments, new risks link to absorption at the end of the programming period such as for example introduction of retrospective projects, introduction of public contracts with in-built ex ante corrections etc.) could not by definition be sufficiently covered during implementation. In that case, the audit authority based on its updated risk analysis and professional judgement should decide whether carrying out specific and additional audit work in view of closure is needed.