

REVISED

DFP - EU FINANCE GUIDANCE NOTE 02/2005 **COMPLIANCE WITH EC REGULATION 438/2001**

5% INSPECTIONS (ARTICLE 10 CHECKS)

Introduction

This is a revision to EU Finance Guidance Note 2/2005 – as amended, on the action that must be taken to ensure compliance with the requirements for 5% Inspections laid down in Article 10 of EC Regulation 438/2001 and the attached Annex 1 provides a model checklist to ensure that all relevant areas are addressed. The Annex includes questions (Section 3.2) regarding compliance with eligibility rules, State Aids issues and the environmental impact of the project(s).

EC Regulation 438/2001 sets out detailed rules for the implementation of EC Regulation 1260/1999. This requires Member States to take a number of measures to ensure that Community Funds are used efficiently and correctly and in accordance with the principles of sound financial management.

September 2007

5% INSPECTION VISITS - ARTICLE 10

5% Sample

1. A minimum of 5% of eligible expenditure of programmes and Community Initiatives must be examined (**Article 10**) so as to: -
 - “verify the effectiveness of the management and control systems in place;
 - verify selectively on the basis of risk analysis, expenditure declarations made at the various levels concerned.”
2. The minimum 5% sample must take into account the need to examine an appropriate mix of types and sizes of projects; any risk factors; and the concentration of projects under certain Intermediate Bodies. The 5% checks must cover each year in which that expenditure takes place. The Commission has recently emphasised the importance of the sample being representative, covering all types and sizes of projects. These factors should be built into the Article 10 work Programme for EU Structural Funds projects.
3. The objective of risk analysis is to direct audit resources to high-risk areas and projects whilst also ensuring adequate coverage of lower risk areas. Risk should be considered in two categories:
 - Inherent risk – the risk related to the nature of the activities and management structures that errors will occur; and
 - Control risk – the risk that internal controls will fail to prevent, detect and correct errors that do occur
4. Different approaches to risk analysis should be used depending on the sophistication of the information system available. Where detailed information on risks associated with individual operations is not available, a more global approach to risk analysis can be used. This may involve identifying risks associated with the main Intermediate Bodies and final recipients, the complexity of the rules and structure of a particular measure, and the overall level of Community assistance. The high-risk priorities or measures having been distinguished, sampling should

then be carried out on the basis of the assessed level of risk but taking account of the requirement for the sample to be representative.

5. In more sophisticated computerised systems which have an integrated risk register, with risk factors recorded at individual operation level, it should be possible to combine the risk analysis function and the sampling of projects to ensure that the sample gives adequate consideration of risk and representivity
6. It is essential that sampling be done by or under the supervision of the designated Article 10 Team, not by the Intermediate Body.
7. In assessing risk, the track record of the applicant, the nature of the project and the amount of grant/total project value are all factors that should be taken into account. A simple risk assessment proforma is attached to this guidance note as Annex 2. The EC audit manual, which gives further guidance, on how risk can be assessed and reflected in the selection of projects to be visited, which has already been circulated to Departmental Heads of Internal Audit, should also be considered.
8. Those reviewing programmes with large numbers of projects may chose to approach risk assessment by focusing initially on the project applicant. This is acceptable as long as it does not obscure the risk posed by individual projects which by their nature are high risk even though they may be managed by an otherwise 'low risk' applicant.
9. It is vital that whatever system for assessing risk is used provision is made for those Intermediate Bodies staff with knowledge of the applicant and/or project to feed in their views to those doing the assessment of risk. Examples include: a low risk rating generally applied to District Council applicants may not be appropriate where it is known a specific project has lost experienced staff or is having other difficulties in its administration or Intermediate Body programme staff may have information about a project which conflicts with its reputation among audit colleagues for submitting well documented and accurate grant claims. In both cases the additional information provided might prompt a higher risk rating.
10. The 5% checks must be carried out on the original documentation wherever that is held in a project. If the project applicant does not hold the original documents, the checks must be extended to a reasonable sample of grant recipients.

11. In order not to be too prescriptive the Article 10 checklist and supporting document checklist at Annex 3 provides an outline of areas to be covered and from this Article 10 Team can plan their visits which will be further refined in light of their own circumstances and agree with their relevant departmental Head of Internal Audit. A common and consistent reporting system has been developed for all Article 10 Teams, which will be subject to ongoing review.
12. As well as examining documents, inspection visits must also include examination of how the project is being managed as a whole and in particular for compliance with all the conditions of grant set out in the offer letter including any attachments or subsequent amendments to it. The visits should cover:
 - for an adequate number of expenditure items, that the nature and timing of the relevant expenditure comply with Community provisions and correspond to the including on-site verification.
 - practical application and effectiveness of the management and control systems
 - for an adequate number of accounting records, the comparison of those records with supporting documents held by intermediate bodies against those held by the final recipients.
 - the presence of a sufficient audit trail.
 - approved specification of the operation and the works actually executed.
 - that the project is consistent with the use described in the application for EU funding and its subsequent offer of grant.
 - that the EU financial contributions are within the limits provided for in Article 29 of Regulation 1260/99 and any other applicable Community provisions and are paid to final recipients without any unjustified reductions or delay.
 - that the appropriate national match funding has in fact been made available; and

- that the EU funded projects have been implemented in accordance with Community rules and policies, including the rules on competition, on award of public contracts, on environmental protection and improvement and the promotion of equality of opportunity.

Calculating the 5% sample

- 13.** The 5% should be applied to the total eligible expenditure for “each form of assistance” (i.e. measure or that part of a Community Initiative for which the Intermediate Body is responsible). Only expenditure declared up to the date of the audit can potentially be counted, not later expenditure for the same project. Audits by the Commission or the European Court of Auditors cannot be counted. In planning the implementation of the inspection strategy the total for eligible expenditure should be taken from the most recent financing plan that has been agreed with the Commission. This is intended to take account of indexation.
- 14.** However, the Commission stipulates that sampling should be spread evenly over the lifetime of the programmes and Community Initiatives concerned, but in proportion to the amounts actually paid. The simplest way to achieve this is to ensure that a minimum 5% sample is drawn from expenditure declared, by the relevant Paying Authority, for each year of the Programme or Community Initiative.
- 15.** While there is no EU requirement to check 5% of eligible expenditure in each measure within a programme, it is our recommendation, given the number of measures that departments are involved in, that each department check 5% of each of their measures to ensure the overall target is achieved.
- 16.** The purpose of checking is to verify the effectiveness of the systems in use in the project and to verify expenditure declarations that have been made. Verification of systems points toward spreading the sample of checks at random over a number of claims. Verifying expenditure declarations implies that all the transactions making up an individual claim must be checked back to primary documentation.
- 17.** Once a project has been selected for monitoring by the application of risk based criteria set out in the monitoring strategy, a detailed examination of all transactions within a single selected claim (or claims) made by that project will be the most effective way of meeting both monitoring objectives. Supporting documents should as a rule be checked 100%. However, where there are large numbers of similar

and repetitive supporting documents such as invoices or proofs of payment it is accepted audit practice to check a random sample of adequate size (say 25%) rather than 100%. The sampling method and confidence level attained should be recorded in the audit report in such cases. However, if the check reveals errors the sample should be widened to establish how widespread these are.

18. The amounts of expenditure counted toward the 5% total may include all the expenditure making up a claim for which a satisfactory sample of primary documentation has been examined (i.e. not just the expenditure actually included in the sample). Such checking should be done 'on the spot' (i.e. at the project concerned) as part of an inspection visit. This is not intended to prevent documentation being checked, exceptionally, 'offsite' where there is no other practical option available.

Monitoring progress towards 5% sample

19. Delivery of the 5% sample is a key control in Regulation 438/2001 and failure to meet it could result in the Departmental Internal Audit Services providing the Commission with qualified Programme/Community Initiative closure statements. This could result in the Commission disallowing expenditure and the UK incurring a direct additional cost. It is therefore necessary for Intermediate Bodies, the Article 10 Teams, Internal Audit Services and European Division, DFP to monitor progress toward achieving the sample. The proforma at Annex 3 is intended to provide the data necessary to do this.
20. Article 10 Teams should complete the proforma at Annex 3 (or their own equivalent), covering each six month period i.e. end June and end December, of each calendar year, by the 21st of the month following the end of each six month period. The returns should be sent to Philip McCartney, EU Division, DFP and copied to the relevant departmental Head of Internal Audit.
21. When carrying out 5% inspection visits the Article 10 Team should:
 - check a sample of grant claims and verify the eligible expenditure against original primary documentation (see paragraph below) recording sufficient detail to enable the amounts of expenditure actually checked to be readily identified and the relationship to specific claims to be clearly discernible.

- complete the attached proforma (Annex 3). This will enable detail of progress toward completing the 5% sample to be reported, to help provide an audit trail and to calculate error rates.

- 22.** Primary documentation is the documentation held by the project that supports the amount of eligible expenditure claimed in enough detail to provide a clear audit trail (as outlined in paragraph 12). In summary the project must be able to show that the eligibility of all expenditure used to calculate the grant claimed can be shown clearly from the documentation it has to hand. This will mean original invoices for work done or purchases made, set out in enough detail to confirm the eligibility of the items listed; time sheets for the calculation of staff costs and details of any in-kind contributions. Documentation that does not make the eligibility of expenditure clear should be questioned.
- 23.** For capital projects involving building and construction, as a general rule, expenditure should be checked against certificates provided by an appropriately qualified Quantity Surveyor. Architects' certificates are not usually detailed enough to provide an adequate check.
- 24.** The Regulation requires the sample to be a minimum of 5% of expenditure that has been declared i.e. declared to be eligible. It is therefore clear that if expenditure is found to be ineligible as a result of substantive checking this does not prevent the amount checked to be counted toward the 5% sample total.
- 25.** However, where expenditure is found to be ineligible checking should be extended to widen the sample to test for further ineligible expenditure and to further test the relevant systems. The extended checks should include further claims at project level and further projects undertaken by the same final recipient. Any further ineligible expenditure found in such extended testing should not be included in the 5% total because of the risk of biasing the sample as a whole.

Records of checks

- 26.** In addition to completion of the proforma described in paragraph 21 above it is vital that details of the documentation checked in on-site visits be recorded by the Article 10 Team in such a way as to provide an audit trail. Each item (invoice, time

sheet etc) should be listed along with a brief description and the amount of expenditure to which it relates. It is not sufficient to just record the total value of the invoices etc checked. This is particularly important since such records will be needed to demonstrate to Commission auditors that the requirements of the Financial Control Regulations have been met.

27. The completed checklist and record of transactions should form the basis of a report on the visit which should include; an explanation of how the examination of the project was conducted; the reason the project was selected; a description of the project and how it is managed, the findings of the visit and details of any irregularity uncovered; the agreed action for correcting these including the amount of any ineligible expenditure. The report should conclude with recommendations for action and arrangements for follow-up, if any.
28. The checks should establish whether any problems encountered are of a systemic character, entailing a risk for other or all projects carried out by the same Intermediate Body/final recipient or in the Member State as a whole. They should identify the causes of such situations, any further examination, which may be required, and the necessary corrective and preventative action. Remedial measures must be recorded and actioned to correct systemic deficiencies.
29. The findings of the visit, the report and recommendations should be provided to the final recipient and Implementing Body for follow-up action and to the Managing Authority whose responsibility it will be to ensure that follow-up action has been taken. Copies should also be provided to the departmental Head of Internal Audit, and the relevant Fund Paying Authority.

The Flowchart attached at Annex 4 gives full details of the Article 10 process

Articles 15-17: Declaration at Winding-up of Assistance

30. Detailed guidance on the closure of the EU Funded elements of the 2000-06 main Objective Programmes and Community Initiatives will be provided by European Division, DFP on receipt of same from the European Commission.

Article 18: Form and Content of Accounting Information

31. Article 18 stipulates that the accounting records referred to in the audit trail requirements at Section 1 paragraph 11 should be held in computerised form as far as possible and should be made available to the Commission on request. The scope of the information that may be requested by the Commission and the preferred technical specifications for the transfer of computer files to the Commission are indicated in Annexes IV and V of the Regulations. The EU database has been set up in accordance with the requirements of Annex IV of the Regulations.

ARTICLE 10 CHECKLIST

Department / IFB	
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Implementing Body details

Name	
Address	
Contact Name	
Tel No	
Fax No	
E-mail	

Project details

Name	
Address	
Contact Name	
Tel No	
Fax No	
E-mail	

Operational Programme / Community Initiative Name	
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Priority No	
Measure No	
Project Ref No	

Total Project Cost	
EU Contribution	
Public Contribution	
Private Contribution	
Revenue	

Brief Project Description

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Name of Visiting Officer		Date of Visit	
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Signature of Visiting Officer.....

COVERAGE OF ARTICLE 10 CHECKS

Calendar year	Period covered by expenditure claim (tick as appropriate)	Amount of eligible expenditure claimed	% of total eligible expenditure checked
2000			
2001			
2002			
2003			
2004			
2005			
2006			
Total			

PRE-VISIT CHECKS ON IMPLEMENTING BODY FILES

1.	Project Application / Letter of Offer	Y	N	<u>Comments</u>
(a)	Has the Application form been properly completed?			
(b)	Are Parts 'A' and 'B' on file?			
(c)	Has the Application been acknowledged / date stamped / time received recorded?			
(d)	Is there a documented project specification with clear targets?			
(e)	Does the project meet all of the Structural Funds' selection criteria?			
(f)	Is there a copy of the Weighting / Scoring matrix on file?			
(g)	Is there a signed Letter of Offer on file – with a date prior to the start of the project? (if signed later than start date – state reason(s))			
(h)	Is there a Letter of Offer Acceptance on file – signed by the identified person or persons responsible for this project?			
(i)	Is there evidence of receipt & analysis of business case / economic appraisal (if appropriate)?			
(j)	Were other sources of Funding declared in the application? [If so, give details]			
(k)	Was an Article 4 check carried out? [If so, is a copy available?]			
(l)	Are there procedures in place to report ineligible expenditure, financial irregularities and/or suspected fraud?			
(m)	Is there a nominated member of staff within the Implementing Body designated to authorise payments to this project?			
(n)	Has the project provided copies of the relevant Insurance Certificates? (if appropriate)			
(o)	Has the project provided copies of relevant Building / Planning permission documentation? (if appropriate)			
(p)	Has project data been input to the Monitoring Database?			

CHECKS ON PROJECT – 1. ORGANISATION STRUCTURE / POLICIES

1.1	Organisational structure and policies	Y	N	<u>Comments</u>
(a)	Is there an organisation structure showing staff employed on this project?			
(b)	Is there a project plan with financial and monitoring targets as in the application? (If so, how is progress monitored?)			
(c)	Is there a written policy for retention of documents? (until December 2013)			
(d)	Is there a written policy on Equal Opportunities?			
(e)	Is there a written policy on Health and Safety?			
(f)	Is there a written policy for meeting EC Regulations on publicity? *			
(g)	Is there a written policy on procurement / tendering?			
(h)	Is there a written policy on data protection?			
(i)	Is there a clear separation of functions between staff involved in the EU project and any other activities of the organisation?			
(j)	Have there been any changes to the project from the original application?			
(k)	Have these been as a result of monitoring / evaluation by the project managers?			
(l)	Was the written approval of the Implementing Body obtained before changes were made?			
(m)	Is there a record of all monitoring activity carried out?			

* There must be a clear recognition of EU funding in all documentation and participants must be aware of EU assistance to the project.

CHECKS ON PROJECT – 2. FINANCIAL INFORMATION

2.1	General and capital costs	Y	N	Comments
(a)	Does the project have an expenditure profile / budget?			
(b)	Is there regular monitoring of actual costs against profiled expenditure?			
(c)	Is there a separate Bank account (or identifiable coding) for this project?			
(d)	Is there a clear basis for apportionment of EU expenditure in respect of overheads, etc?			
(e)	Where this expenditure has been apportioned, is there evidence of payment from other sources for the balance?			
(f)	Is there supporting documentation for all expenditure claimed?			
(g)	Are there original invoices for all expenditure charged to the EU project?			
(h)	Where there are non-invoiced costs are they supported by relevant official documentation?			
(i)	Is there an up to date Bank Statement?			
(j)	Is there evidence of a regular reconciliation between invoices, receipts, cheques and Bank records?			
(k)	Is there written authorisation for staff to sign cheques? (specify name / and the financial limit for each person)			
(l)	Have all the cheques been signed by the authorised signatories?			
(m)	Are any cheques pre-signed?			
(n)	Is there a written policy on the use of petty cash?			
(o)	Have petty cash payments been made in line with this written policy?			
(p)	Is the organisation registered for VAT?			
(q)	Does all expenditure claimed exclude VAT?			
(r)	Does the project generate revenue?			

(s)	Is there evidence of receipts in respect of income and has it been offset against this project?			
(t)	Is there an assets register for all capital items purchased?			
(u)	Are all capital purchases claimed identifiable in the register?			
(v)	Is there a record of the Serial No of each item of capital equipment?			
(w)	Is there any capital item not purchased new?			
(x)	Has the project complied with the eligibility Regulations regarding the purchase of second hand equipment (as detailed in Regulation 1685/2000 amended by Regulation 448/2004)?			
(y)	Is the purchase price reasonably consistent with the overall age / condition of the asset?			

CHECKS ON PROJECT – 2. FINANCIAL INFORMATION

2.2	Staff costs and expenses	Y	N	Comments
(a)	<i>Where staff costs are charged is there evidence that they were calculated as outlined in the Letter of Offer?</i>			
(b)	Is there evidence that they are employed exclusively on this project?			
(c)	If costs for staff time are apportioned, is the basis for this identifiable? (If so, provide details)			
(d)	Is there a signed weekly / monthly timesheet for staff, with clearly identified time spent on this project?			
(e)	Is there a P11 (manual / computerised) for each member of staff?			
(f)	Is there a written policy detailing travel & subsistence allowance rates for the EU project?			
(g)	Is there a written policy regarding hospitality? (limits and approval procedures)			
(h)	Have all staff expenses included in the claim(s) been submitted in			

	accordance with these policies?			
(i)	Is there documentation to verify that all staff travel / subsistence claims have been paid?			
(j)	Do the amounts paid agree with the amounts claimed?			

CHECKS ON PROJECT – 2. FINANCIAL INFORMATION

2.3	Expenditure claims by projects	Y	N	Comments
(a)	Has the person who signed the claim been authorised to do so by the organisation?			
(b)	Does the same person sign all expenditure claims?			
(c)	Is a checklist used for claim information before it is declared?			
(d)	Can all match funding be clearly identified on each claim?			
(e)	Can all claim information be verified from the project's accounting records?			
(f)	Are all original invoices endorsed with cheque / payment details when paid?			
(g)	Has an arithmetical check been carried out on all expenditure included in the claim?			
(h)	Was this check carried out by a person or persons independent of the person who signed the claim?			
(i)	Has all, or a sample of expenditure declared in this claim been incurred and paid within the eligible dates for the project?			
(j)	Does the project produce certified and audited annual accounts? (if so, are these submitted to the Implementing Body?)			

CHECKS ON PROJECT – 3. GENERAL

3.1	Tenders for works or services	Y	N	Comments
(a)	Where a project is required to tender work or services, is this in line with procurement policy?			
(b)	Were tenders recorded and evaluated against set criteria?			
(c)	Are decisions to award / refuse clearly documented and held on file?			
3.2	Compliance with EU Regulations			
(a)	Is there evidence of compliance with the eligibility rules as described in Regulation (EC) No 448/2004 – in particular with regard to: <ul style="list-style-type: none"> • The purchase of land • The purchase of real estate (where appropriate)			
(b)	Is there evidence of compliance with the limits of assistance as defined in the relevant State Aid scheme (where appropriate)?			
(c)	Has an environmental impact assessment been carried out (where appropriate)? If 'yes' provide summary details of the findings			

ESF ONLY – 1. FINANCIAL CONTROL

1.	Monitoring & verification (beneficiaries / participants)	Y	N	<u>Comments</u>
(a)	Is there a signed application form for each participant?			
(b)	Does each participant meet the criteria for the project? (age, length of time unemployed, etc)			
(c)	Is there a timesheet for each participant – signed by the participant and a member of staff?			
(d)	Do the starting and finishing dates for training agree with the period claimed?			
(e)	Is there a training needs analysis for each participant? (if so, note the date it was carried out)			
(f)	Is there a record of the outcome of the training activities carried out? (certificate, etc)			
(g)	Is there a weekly / monthly reconciliation of payments against signed timesheets submitted?			
(h)	Is there a record of payments made? (cheques, BACS transfers, etc)			

ANNEX 2

AUDIT TESTING STRATEGY: PROJECT SELECTION

RISK FACTORS

<u>Category</u>	<u>Risk</u>	<u>Description</u>	<u>Score</u>
(a) Project eligible spend See Note 1.	Low	Less than £100k	1
	Medium	Greater than £100k but less than £500k	2
	High	Greater than £500k	3
(b) Type of provider	Low	Local authority/business link	1
	Medium	FE/HE Institutions	2
	High	Other e.g. private companies, voluntary sector, etc	3
(c) Track record	Low	Good e.g. claims accurate and prompt, no problems identified by monitoring visits, etc.	1
	Medium	Adequate e.g. most claims accurate and prompt, minor problems identified by monitoring visits, etc	2
	High	Poor e.g. claims inaccurate and/or consistently late, major problems identified by monitoring visits, etc.	3
(d) Overall Risk	Low		3-4
	Medium		5-6

Example

A project with total expenditure eligible for EU support of £1m is managed by a District Council. A recent visit by the monitoring team found a number of major problems, including claims based on estimates rather than defrayed expenditure and the inclusion of ineligible items. The project was assessed as 'high risk' as follows: -

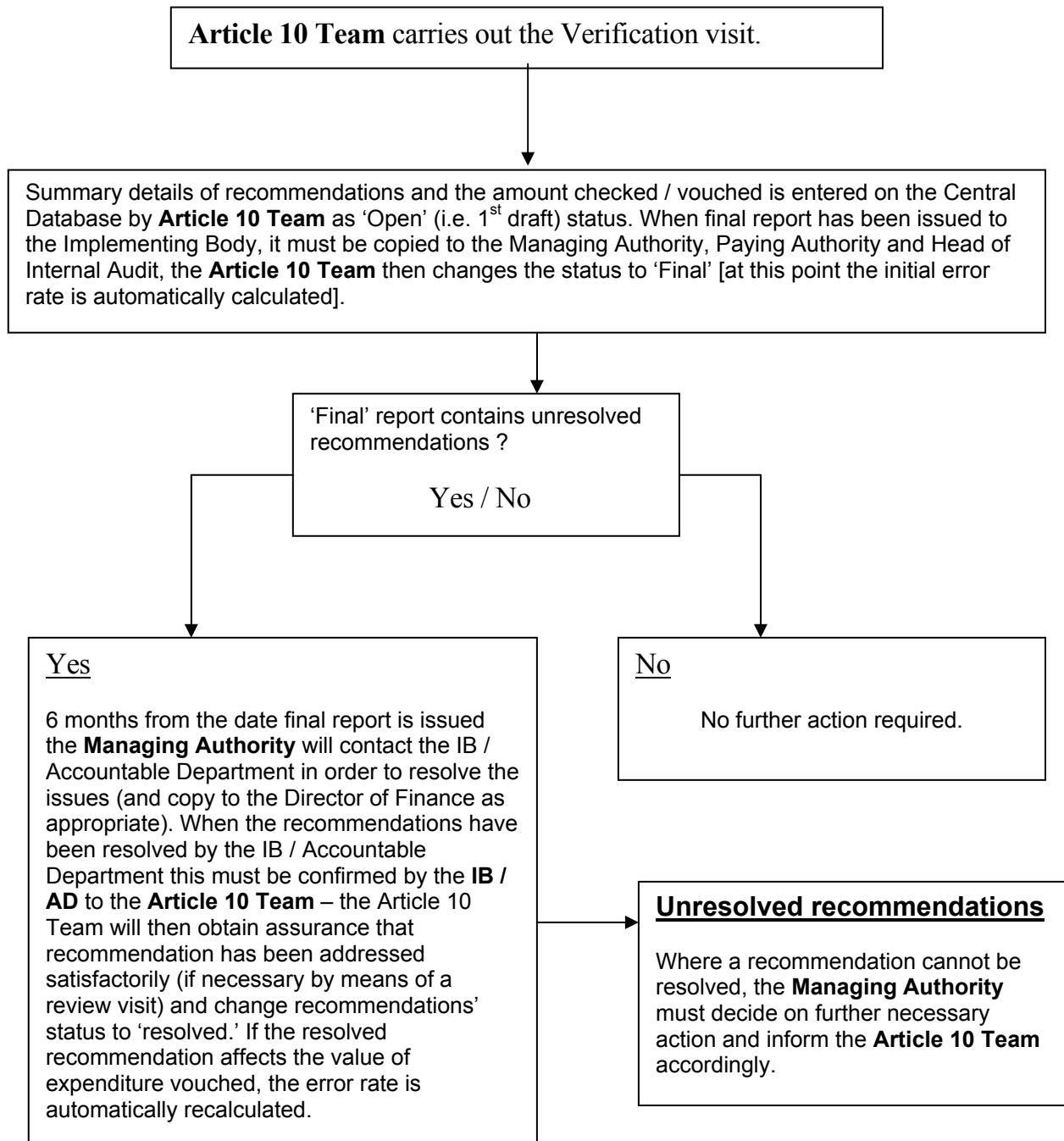
(a) Project eligible spend	3
(b) Type of provider	1
(c) Track record	3
(d) Overall Risk	7

Notes:**HIGH**

1. The values may need to be varied to reflect the circumstances of individual projects. For example, a project with an eligible spend of £100k may be relatively large in one of the smaller programmes.

- Column 2 - total eligible expenditure planned to be spent over the lifetime of each programme/CI included in Column 1 – broken down for each year where expenditure is planned.
- Column 3 - 5% of the total planned eligible expenditure per year – in effect this is the target figure for each programme/CI we should be aiming to deliver.
- Column 4 – total eligible expenditure per year included in the substantive checking described above. Data in this column will always be cumulative from the start of the programme/CI to the end of the reporting quarter.
- Column 5 – Column 4 as a percentage of Column 2, which gives the progress, made toward the target figure for each year.

ANNEX 4



NB: When a Fund Paying Authority receives an Article 10 Report and the contents cause the PA to have reservations about including expenditure from that IB / project in a payment application to the Commission, the PA must inform the relevant Managing Authority as soon as possible