

How to Deal with Legal Uncertainty: Managing and Audit Authorities in Cohesion Policy

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Cohesion policy (ERDF, ESF and CF) is implemented in a system of shared management. Signals received from some EU countries indicate that legal uncertainty is created for beneficiaries of cohesion policy funds due to differences in interpretation of, mostly national, regulation. This is a problem because the prospect of legal uncertainty, with the consequence of returning paid subsidies, and the audit burden associated with European funding, may deter organizations from applying for funds. This paper tries to gain a first insight in how this legal uncertainty is created and whether these differences in interpretation are found across the EU. This study focuses on the relationship and communication between the management and audit authorities and the effect of this dialogue on legal certainty and the way audit is carried out under a shared management system. We touch upon the fear of audits, fear because professionals feel they are under constant challenge of being undermined in the future.

I. Introduction

A Managing Authority (MA) is required to check that all projects comply with the applicable (national and EU) laws and that expenditure of beneficiaries is regular and follows all legally required procedures. How far does the MA need to go in addressing legality and regularity? If, for example, a permit is needed to construct a particular building, is the MA obliged to check whether the municipality concerned has issued a permit, or also whether, according to regulations, this permit has been rightfully issued? MAs in several EU member states struggle with such differences in the interpretation of regulations. Aside from creating disagreements between Audit Authority (AA) and Managing Authority¹, this is problematic for beneficiaries, creating confusion and legal uncertainty. This study is an attempt to gain a first insight into the extent to

which interpretations vary between Managing Authorities and Audit Authorities in European Union Member States in the area of cohesion policy. Through interviews with representatives from Managing and Audit Authorities in several EU Member States, it explores how differences in interpretation between MAs and AAs are dealt with and the resulting legal uncertainty for beneficiaries. We also reflect on the valuable feedback received from practitioners that the volume of legislation, in practice, is increasing rather than decreasing (see figure 1). Further, the study is aimed at gaining insight into the communication and relationship between MAs and AAs, and how these may relate to such differences in interpretation (of both national and EC regulatory provisions).

The first part of this paper explains some of the main concepts and their relevance. The second part focuses on the management and control system for

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1 The Audit Authority (AA) is a national, regional or local public authority or body designated for each operational programme and responsible for verifying the effective functioning of the management and control system. The AA's tasks include checking whether the management and control systems are working efficiently (system audits). The AA is functionally independent of the Managing Authority (MA). Under the auspices of the EU's cohesion policy for 2014-20, a MA is responsible for the efficient management and implementation of an operational programme. The MA may be a national ministry, a regional authority, a local council, or another public or private body that has been nominated and approved by a Member State. MAs are expected to conduct their work in line with the principles of sound financial management.

cohesion policy. In the third part we present case studies comparing various Member States on topics (such as communication and guidance) which we believe to be relevant to the issues of legal certainty. The fourth part discusses the tensions in the system, which may prove problematic. This paper argues that some Member States report differences of interpretation, while others do not. It is difficult to pinpoint an exact cause of the difference, but it seems that communication and cultural differences are influential. Moreover, we know only as much as people are inclined to tell us, which may differ between Member States. Part V describes the different approach to legality in auditing and justice. In the discussion and conclusion section, these aspects are further discussed.

1. Focus of the Study

This paper focuses on Managing and Audit Authorities in cohesion policy (ESF, ERDF, Cohesion Fund) and the legal uncertainty and audit burden seen from a systemic point of view. Other important concepts in this paper are trust vs control, rules-based vs principles-based, and the audit- and control system in shared management.

The European Commission issues each year an ‘error-rate’ for each operational programme (OP) or groups of OPs. This rate measures the share of irregular spending declared by national authorities to the Commission. Member States are then required to make financial corrections to compensate for these errors. This means that less money is made available from the EU budget and irregular spending is paid from the national and/or regional budgets in the Member States. In parallel, the European Court of Auditors also publishes an ‘error-rate’ which is comparable to the Commission’s error-rate. The intention to reduce error-rates and to avoid financial corrections puts pressure on national authorities to strictly interpret the rules and beneficiaries to understand the rules up-front. This ‘pressure’ (or “preventive fear” of financial implications) on the national authorities adds to the necessity to design clear and easy to understand EC and national rules. It can also be argued that the ‘error-rate’ is a reflection of the complex and burdensome (EC and national) regulation.

On the drawing board, rules might seem clear and logical; but in real life, regulations often come with

grey areas. Friction between a MA and an AA need not, in itself, be problematic: MAs may make mistakes, and audits are part of a well-functioning system. MAs and AAs may also not agree on whether a specific expenditure is legal and regular.

However, it is problematic for beneficiaries if there is no harmonised interpretation of eligibility rules within a Member State or between a Member State and (different) Commission services, this then leads to legal uncertainty. Legal certainty is the ability to predict the official’s behaviour and the ability for actors to organise their affairs in order not to break the law. This uncertainty is aggravated in cases where different auditors (either from different authorities or in subsequent years) differ in their opinions.²

Such differences may leave the beneficiary unable to rely on the MAs judgment and guidance, and having to pay back funds. A recovery of limited amounts of funding might be easily overcome, but what if the amount involved is considerable? Most likely, there are other consequences: to prevent differences from arising MAs may apply a risk-averse strategy, increasing the number of checks they perform and making national regulations stricter (gold-plating), thereby increasing the audit burden on the beneficiary.

This leads us to the second focus of this paper: the audit burden. The Commission is committed to simplifying legislation.³ This is apparent, for example, from its establishment of the High Level Group of Independent Experts on Monitoring Simplification for Beneficiaries of the European Structural and Investment Funds.⁴ Nonetheless, in practice, the volume of legislation is increasing rather than decreasing, as additional regulations are made and transposed into national legislation in order to clarify existing regulations. However, this also increases the scope for interpretation. Figure 1 gives an indication of the audit burden by showing the amount of expenditure audited in the Member States in 2015. There are concerns that the approach of the Commis-

2 For further discussion, see also articles by Brenninkmeijer and Lenaerts, for example, Lenaerts, K., ‘The Activities of the European Court of Auditors and the General Principles of European Union Law’ [2015] ECA Journal, p. 4, 10.; Brenninkmeijer, A., ‘The Need for Principles of Good Audit’ [2015] ECA Journal. P. 11, 15.

3 European Commission, ‘High Level Group monitoring simplification for beneficiaries of ESI Funds’, retrieved 11 October 2016 from: <http://ec.europa.eu/regional_policy/de/policy/how/improving-investment/high-level-group-simplification/> (last accessed on 9 May 2017).

4 Ibid.

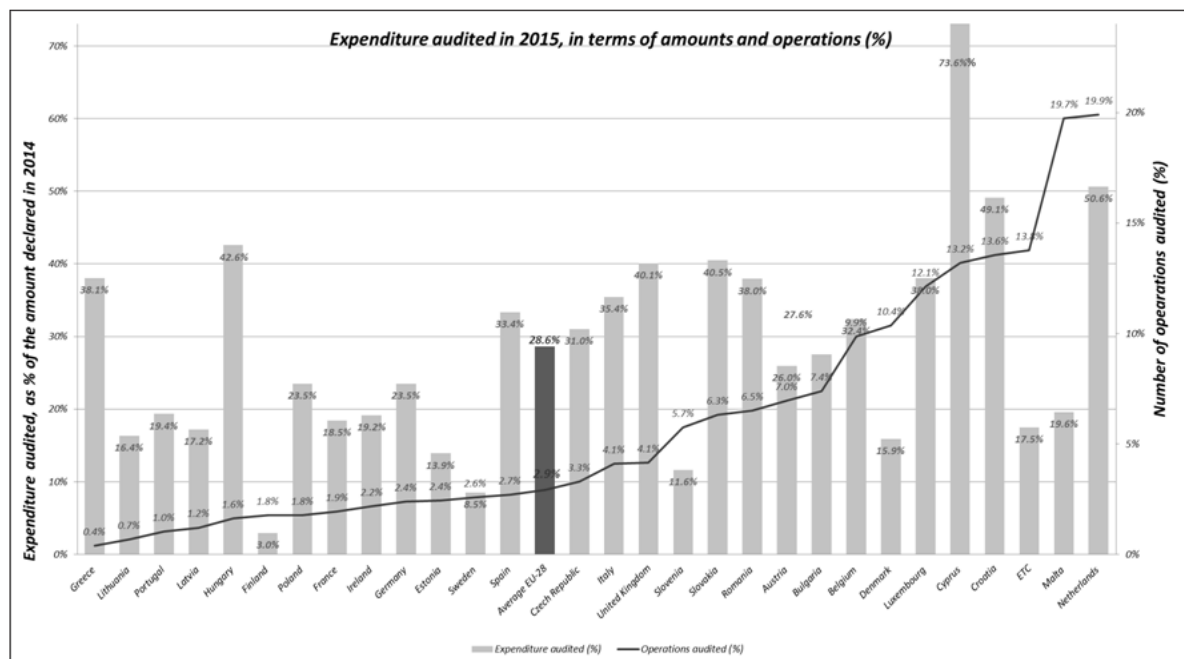


Figure 1: Expenditure Audited in 2015.

Source: European Commission, DG REGIO (2016, based on the analysis of the 2015 annual control reports).

sion and the working groups may not ultimately touch the core of the problem, although the problem has been highlighted as far back as Agenda 2000.⁵

Beneficiaries consider the risk of corrections due to irregularities to be substantial and participants from the private sector sometimes consider that the costs of EU funding outweigh the benefits.⁶ In Belgium, for example, it was noticed that the number of companies registering for educational projects under the ESF had declined from 150 to 50 within the space of a few years, in spite of increased efforts to encourage participation by them. In the Netherlands, there are companies that have reportedly stopped apply-

ing for EU funds because of the burden and legal uncertainty associated with them. This trend has also been recognized in the academic literature.⁷ A Dutch study also claims that the audit chain is burdensome because of the focus on detailed checks of receipts and explicit proof of their regularity.⁸ The costs and risks for financial corrections on the committed subsidy are experienced as ‘considerable’ for the beneficiaries, for example an innovative entrepreneur. It is important to focus on these problems because it affects negatively the effectiveness of EU policy, to create growth and jobs.

2. The Importance of Clear Communication

Good communication and a good relationship between authorities in the audit and control system are essential to enable them to identify gaps in the system and to minimise irregularities.⁹ The multiplicity of authorities, their roles and their views make clear communication towards beneficiaries key: if it is not clear how to interpret the rules, this might lead to legal uncertainty for the beneficiary. The Commis-

5 European Commission Communication (1997) Agenda 2000: For a stronger and wider Union, Brussels, 16 July 1997.

6 Huis van de Nederlandse Provincies en Interprovinciaal overleg, ‘Nederlandse provincies voor betere EU-regelgeving’ (2015) p. 15.

7 Mendez, C. and Bachtler, J., ‘Administrative reform and unintended consequences: an assessment of the EU Cohesion policy ‘audit explosion’ (2011) Journal of European Public Policy, 18:5, 759; Huis van de Nederlandse provincies en Interprovinciaal overleg, ‘Nederlandse provincies voor betere EU-regelgeving’ (2015) p. 15.

8 Ibid.

9 Markevica, M., ‘Management and Control System of ESI Funds’ [2015] European Structural and Investment Funds Journal p. 96.

sion has emphasized that the audit process is not only about verification, but also a learning process;¹⁰ finding solutions to prevent mistakes in the future. This requires a risk-management-oriented rather than a sanction-driven approach.¹¹ Our paper examines in what way the relationship between the Audit Authority and Managing Authority affects the (perceived) legal certainty of beneficiaries and (perceived) audit burden by the Managing Authority.

The results and analyses in this paper are based on interviews with senior representatives from Managing Authorities and Audit Authorities across the EU (Austria, Belgium, Bulgaria, Lithuania, Luxembourg, Netherlands, Poland and Spain). In each Member State, we spoke with the Audit Authority and at least one Managing Authority and/or Intermediate Body (IB). We did not speak in every Member State with representatives of all three funds. Therefore, the results of the interviews do not reflect all funds or authorities in a Member State. We held additional interviews with representatives from the Commission's Directorate-General for Regional and Urban Policy. The study is mainly focused on the 2007-2013 period.

II. System

1. Actors

Cohesion policy is implemented under shared management. We would argue that the complexity of Co-

hesion policy management is threatening the reputation of the EU policy. Therefore the main question, from this perspective, is: how does the management of the control system assign roles and responsibilities to the different authorities, and how does it influence their functioning and mutual relationships? In this part, we will firstly state the tasks of the relevant actors, and secondly, summarize the audit process.

Since the Lisbon Treaty, the Member States and regions have an important role in managing the available funds, while the European Commission has a supervisory role and together with the Member States bears the shared responsibility for the EU budget as a whole.¹² National eligibility rules determine which costs can be reimbursed.¹³ They need to comply with general rules set out in EU regulations.

Each Member State is responsible for implementing the funds at national and regional level, and for 'preventing or detecting and correcting irregular expenditure, and report to the Commission'.¹⁴ It delegates these tasks to one or multiple MA(s).¹⁵ The European Commission has a supervisory role and together with the Member States bears the shared responsibility for the EU budget as a whole.¹⁶

The MA is responsible for selecting projects and managing the programmes, and must verify that expenditure declared by beneficiaries is legal and regular.¹⁷ Some functions may be delegated to intermediate bodies (IBs). The MA advises beneficiaries on how to comply with the terms and conditions of EU funding.¹⁸ Declared expenditure is certified to the

10 S., Davies, F., Gross, and L., Polverari, 'The financial management, control and audit of EU cohesion policy' (IQ-Net Thematic Paper 2008) 23(2) p 16.

11 Mendez, C. and Bachtler, J., 'Administrative reform and unintended consequences: an assessment of the EU Cohesion policy 'audit explosion'' [2011] *Journal of European Public Policy* 18:5, 755.

12 Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326/47 Art. 317; Damen-Koedijk, M., *EU Cohesion Policy & Accountability: Coverage, Context & Costs in the case of ERDF in the Netherlands* (2016) p. 128; European Commission, 'Budget. Who manages the money?', retrieved 11 October 2016 from: <http://ec.europa.eu/budget/explained/management/managt_who/who_en.cfm> (last accessed on 9 May 2017); European Court of Auditors, *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion* (Special report No. 16/2013) p. 16.

13 Court of Auditors [2015] OJ C 373/168 par 6.10, 6.11.

14 Notices from European Union Institutions, bodies, offices and agencies: Court of Auditors [2015] OJ C 373/168.

15 Damen-Koedijk, M., *EU Cohesion Policy & Accountability: Coverage, Context & Costs in the case of ERDF in the Netherlands* (2016) p. 128.

16 Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326/47 Art. 317; Damen-Koedijk, M., *EU Cohesion Policy & Accountability: Coverage, Context & Costs in the case of ERDF in the Netherlands* (2016) p. 128; European Commission, 'Budget. Who manages the money?' retrieved 11 October 2016 from: <http://ec.europa.eu/budget/explained/management/managt_who/who_en.cfm> last accessed on 9 May 2017); European Court of Auditors, *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion* (Special report No. 16/2013) p. 16.

17 Fortvingler, J., *A Co-ordinated model of Auditing EU Funds under Shared Management* (2012) p. 27; Commission of the European Communities, *Communication from the Commission to the European Parliament and the Council* (Com 2004) 580, page 5, Article 34(1).

18 Office for the Official Publications of the European Union, *The control system for Cohesion Policy: How it works in the 2007-2013 budget period* (2009) p. 8.

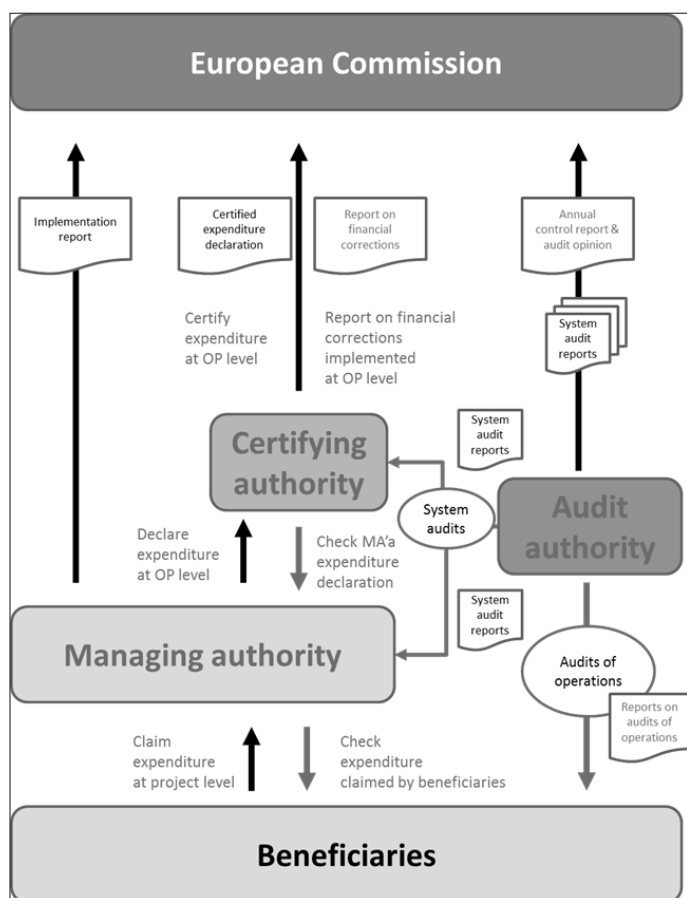


Figure 2: Control Arrangements in Cohesion Policy (2007-2013 Period).
 Source: European Court of Auditors, *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion* (Special Report No. 16/2013) Figure 2, p. 13.

Commission by the certifying authority (CA).¹⁹ CAs are beyond the scope of this paper. The AA verifies that the MAs and CAs effectively carry out their work, through system assessments and on-the-spot checks on project expenditure, including at the level of beneficiaries.²⁰ The AA must be functionally independent from the MA and the CA.²¹ The Commis-

sion ultimately oversees the proper establishment and operation of control systems in each Member State by supervising compliance assessments, approving audit strategies and checking the AA's annual control reports and audit opinions.²² Furthermore, it provides guidance and discusses regulatory and control issues with Member States and AAs.²³ Where it finds irregularities, based on the evidence from the AA, the Commission may impose corrections on Member States.²⁴ This is often accompanied by 'action plans' meant to resolve the difficulties at the root.

During the 2007-2013 period, the Commission attributed a 'single audit' status to OPs in accordance with Article 73 of the regulation.²⁵ This is a statement by which the Commission certifies that the Member State's monitoring and audit systems provide a certain level of assurance and robustness and that its AA can be relied upon. If so, the Commission relies on the opinion issued by the AA and will not per-

19 Ibid.

20 Fortvingler, A., *Co-ordinated model of Auditing EU Funds under Shared Management* (2012) p. 28.

21 European Court of Auditors, *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion* (Special report No. 16/2013) p. 11.

22 Ibid.

23 Ibid.

24 European Court of Auditors, *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion* (Special report No. 16/2013) p. 14.

25 Article 73 from the 2007-13 Council Regulation (EC) No 1303/2013.

form (or will limit) its own on-the-spot checks, unless it has specific reason to believe that weaknesses exist in the national system.²⁶ The Commission then focuses more on strategic approaches and limits itself to the minimum audit procedures necessary to rely on the work of others in accordance with international auditing standards. AAs that work under such arrangements, such as in Austria, the Netherlands and Poland (since 2016) consider this to be a recognition of their competence and of the quality of their work. Yet, these arrangements hardly have an effect on the number of audits of beneficiaries since nearly all audits are carried out by the audit authorities in the Member States, and not by the Commission.

Austria's AA argued that 'contracts of confidence' during the 2000-2006 period (the precursor of the Article 73 during the 2007-2013 period) may have had a negative impact. According to the AA, MAs seemed to interpret the fact that the AAs received a contract as proof that the MAs were also applying the regulations properly. The AA reported that MAs were not accepting its findings and were criticising it for being too strict, when in fact the AA argued to be working according to Commission's standards. Because the Commission was no longer carrying out its own audits, the MAs were said to be under the impression the AA was stricter than the Commission would have been.

The AA calculates an error rate based on the irregularities found in the sample of transactions examined during the year. This sample must be representative and is generally determined based on a statistical method. The MA can decide whether or not to follow-up on these errors with corresponding financial corrections.²⁷ In cases of non-disputed findings, the MA will make these corrections immediately. It may exclude irregular claims from a request for payment and propose revised claims that are eligible for funds. The MA makes corrections either by reclaiming the money in question from the beneficiary or deducting it from future payments. Alternatively it may decide to directly reimburse the irregular expenditure claimed to the EU budget.

In Bulgaria, the State has covered corrections made on Public Procurement expenditure in 2012, since the beneficiaries obeyed national laws which were not in alignment with European regulation.

2. Audit Process

In a contradictory procedure, the MA, IB and beneficiary are given the opportunity to respond to the findings of the AAs and to provide additional documentation and/or arguments to contest findings. The AA takes these into consideration before finalising its audits. The AA submits the results of its audit work to the Commission in an annual control report consisting of the system audit and a summary of the project reports and an opinion. The annual control report includes the annual error rate for that year, irregularities and corrections, and the MA's position if it disagrees with the audit opinion. A copy of the annual control report is sent to the MAs and the IBs and a copy of the project audit reports are sent to the examined beneficiaries for information.

The Commission reviews the annual control report and examines in particular whether the MAs have adequately applied the financial corrections proposed by the AA. If this is not the case, the Commission can take a legally binding financial correction decision itself. However, there seem to be some issues that can be problematic. Firstly, in interviews the Commission underlined its role in protecting the EU budget, thus examining findings and corrections to make sure the AA did not omit something. If AAs are stricter than they need to be, this is thought as not important. Secondly, the Commission does not seem to be aware of all differences between MA and AA, in particular in those cases where the two authorities disagree in their interpretation of national regulation. Thirdly, given its legal mandate, the Commission shies away from getting involved in such interpretation of national regulation. In general, the Commission trusts the AA to do a good job and resolve any disagreements at national level, which may not actually be the case. If the Commission does not look into these differences in interpretation, we would argue that the AA becomes a de facto decision maker.

²⁶ Ibid.

²⁷ European Court of Auditors, *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion* (Special report No. 16/2013) p. 13.

III. Case Studies

For this paper we conducted a series of interviews which were focused on several elements of importance for (resolution of) interpretation differences. These elements are communication, relationship and guidance. In the following section, the differences between Member States and its impact on these elements and on the audit burden and legal certainty are discussed.

1. Communication

The interviews reveal that communication between the MAs and AAs is fairly similar in the Member States examined. All Member States have meetings between the directors of MAs, CAs and AAs, and meetings between MAs, working groups, etc., although they differ in frequency. Before and after an audit, the MA and the AA have opening and closing meetings in which projects are presented and discussed. In some Member States, the MA is present during on-the-spot checks of beneficiaries. In most Member States, findings are presented only formally through the audit reports for individual projects and systems checked by the AA. In the Netherlands, for example, importance is placed on findings also being shared and checked before the report is written to prevent findings based on misunderstanding from being included in a report.

In addition to formal communication, informal communication is generally seen as important, but its use varies depending on personal preferences and relationships. Its frequency seems to vary in some Member States:

- In the Netherlands, this communication has increased and improved over the years, being tense a few years ago, hindering the resolution of interpretation differences.²⁸
- In Austria, communication seems to be strictly about audit and is not for the purpose of exchanging views of the different actors on specific issues.
- In Bulgaria, informal communication is made very easy, as the Audit Authority is located on the same floor as the interviewed Managing Authority.

- In Spain and Belgium, a data platform has been set up, to which beneficiaries upload documents used for audits during the project. The AA has access to this data during the audit. Interviewees argue that this makes archiving and transferring documents easier.

In some Member States, communication is quite formal. Due to missing informal communication, important information on the context of the findings may be lacking in terms of quality, which may be a factor in the differences in interpretation.

2. Relationship

In general, the relationship between MAs and AAs is characterised as good and cooperative. AAs see the relationship as a purely cooperative one. Several MAs also describe it as hierarchical even though in theory the regulation does not provide for that. This is for example the case in Poland, where one MA and IB described the relationship as hierarchical, in addition to being one with good cooperation, and stated that there was trust between the authorities. In Austria, Belgium and the Netherlands also, MAs see the relationship as hierarchical, but unlike in Poland, they are not always willing to accept the AA's views due to fundamental differences in their interpretation of certain cases.

In Belgium and the Netherlands, this led to tensions between the authorities. In Belgium, some differences in the interpretation of the regulations (on how to apply simplified costs options) were solved through mediation by the Commission.

In Belgium, the European Commission acted as mediator in a conflict between the AA and the MA to resolve a difference of opinion on how to apply simplified costs options. The Commission was not involved in the subject matter of the dispute, but rather acted as a facilitator of discussions between the MA and the AA.

In the Netherlands, the Ministry of Economic Affairs was the mediator. Since Summer 2016, it has been decided that, in such cases, an external expert should adjudicate rather than the Ministry and that this ruling will, in principle, be accepted by all authorities.

²⁸ Commissie van Goede Diensten, *pijnpunten in de controle van EFRO-2 subsidies in Nederland* (2015), p. 11.

However, this may result in additional tensions since the AA is fully independent and cannot be overruled by others.

Perhaps cultural differences play a role here. When hierarchy plays a larger role in relations this might have an effect on the reported differences. This may be the case in Poland.²⁹ This hierarchical difference may also be apparent in the relationship between beneficiaries and MAs. In Belgium and the Netherlands, the MAs expressed their concern to ensure that beneficiaries should have legal certainty. In Poland, it seems rather to be taken for granted that the beneficiary should have to return money when the AA makes findings. Thus, while in general the relationship is seen as good, in some Member States it is also seen as hierarchical. This could correlate with reported interpretation differences in such a way that more hierarchy leads to fewer discussions on the interpretation of rules.

3. Guidance

Simplification was a major theme during the debate on Cohesion policy for the 2014-2020 period. Besides simpler and more harmonised rules and consistent (multiple-layer) control and audits, an often used method to clarify legislation is by issuing guidelines. This can help to resolve differences in interpretation. The interviews therefore also focused on the question of guidance. Sources of such guidance may include (documents from) the Commission, the AA, ministries or (national) experts. The Commission issues guidance notes³⁰ to clarify specific provisions in the regulations – including on demand guidance from their ‘helpdesk’. In Austria, a dispute about whether salaries at management level are classified as indirect or direct costs was resolved this way. Member States and MAs are reluctant to request guidance, as it may take a long time for guidance to be given and it may not clarify much. One of the interviewees dubbed the Commission ‘the Oracle of Delphi’, because even its guidance was perceived as being hard to interpret and very general. There was a feeling that the Commission issued too much guidance, only adding to the volume of existing rules. Also its status is disputed as the Commission’s checklist is reportedly being used by some Audit Authorities as a mandatory requirement. Most MAs regard guidance notes as exactly that: guidance on how a regulation

can be applied. Some AAs stated that the notes were binding; they are viewed as ‘soft laws’ and their perception is that they have to be followed.

The Commission is not the only source of guidance: particularly on national legislation, national experts may also be involved.

In Poland, for example, the MAs involved the Public Procurement Office in dealing with issues relating to Public Procurement.

AAs also consult national experts when in doubt.

An interesting question is whether the MA can ask the AA for guidance beforehand. In some Member States such as Austria, Bulgaria, Lithuania and Poland, it cannot: the AA is independent and checks only after the event. The roles of auditing and advising are thus strictly separated. In Spain the view is that it is better to prevent an irregularity than to make a correction later. The AA in Belgium and the Netherlands argue that ex-ante advice does not compromise the AA’s independence: if a case is looked at carefully, the AA will come to the same conclusion later during the audit. Ex-ante advice is given strictly on the basis of the individual case in question and the facts as presented at that time. If other relevant facts emerge later, the AA feels free to reconsider its assessment. Experiences on ex-ante advice indicate that guidance from the Commission is not seen as a tool to prevent or resolve interpretation differences as it is too general and too late. Some AAs are open to ex-ante guidance, while others are not. Some MAs do see ex-ante guidance from the AA as helpful to prevent interpretation differences.

4. Audit Burden

In the last decade, the Commission’s reforms (harmonisation of rules between ERDF/ESF and with other ESI-funds (EAFRD, EMFF)) have been accompa-

29 Hofstede, G., *Culture’s Consequences: Comparing Values, Behaviors, Institutions, and Organizations Across Nations* (Second Edition, Thousand Oaks CA: Sage Publications, 2001).

30 Available online at <http://ec.europa.eu/regional_policy/en/information/legislation/regulations/> (last accessed on 9 May 2017).

nied by an audit explosion.³¹ The general Regulation on ESI funds (Regulation 1303/2013) has nearly doubled in volume from the 2007-2013 to the 2014-2020 period, while the Delegated and Implementing acts have tripled. This is recognized in the interviews: there is a complex Cohesion policy management, and the need for further simplification to foster trust among those who are controlled or audited and those who control or audit them. Although on the spot checks by the Commission or the Court of Auditors can be limited, additional management verifications and/or work by national Audit Authorities contribute significantly to the overall burden for beneficiaries.³²

In the interviews, it was not possible to pinpoint how much time involved stakeholders (beneficiaries and MA) spent on an audit by the AA. However, it can be said that in the Dutch case AAs have more time to concentrate on the audit of a project than the MA, because the MA 'manages' the project i.e. has to use its capacity for more than pure auditing.³³

Arguably, such an uneven balance has an impact on the MA's and AA's respective approaches: the MA's main purpose is to manage and implement programmes. Its first-level control cannot be as thorough as the AA's audits and, furthermore, the MA must cover all projects and beneficiaries. The AA takes a sample of projects and focuses on just a few, so can dig deeper for irregularities. This enables the AA to go further into depth to find errors.

5. Legal Certainty

The results concerning differences in the interpretation on legislation differ from one Member State to another. Bulgaria, Lithuania, Poland and Spain reported few problems with differing interpretations. The AAs and MAs in these Member States do have differences relating to findings, but these are resolved during the contradictory procedure. In Poland, all decisions by the AA are implemented by

the MA after the final report, whether the MA agrees or not. In Lithuania, if the AA and the MA cannot agree, other institutions may be consulted, such as legislators or experts. Luxembourg reports problems rather with multiple audits and differences in interpretation between the AA and the ECA.

In Austria, Belgium and the Netherlands, the authorities do report differences in interpretation even after the contradictory procedure. These differences often concern national regulation, albeit on the same topics: simplified cost options, the application of all laws and the documentation of performance are the most frequent. Companies are allowed to simplify costs, but often end up receiving funding that is lower than the actual costs incurred. When companies happen to receive funding in excess of their actual costs, are their claims still accepted? Or do actual invoices need to be provided by way of documentation, thereby negating the cost simplification?

Another rule that creates problems is the requirement that projects adhere to all applicable laws: but what does that actually mean? Do MAs only need to check whether a municipality issued the permit that is needed for a project, or also whether this permit was granted based on the right arguments?

Other examples of differences in the interpretations of legislation given by MAs include differences relating to education standards: in Belgium the MA was asked to explain how a university degree in Biology was considered relevant for working for the MA. In Austria, differences arose over the interpretation of infrastructure costs: did such costs include only bricks and concrete, or also the labour costs for the construction work?

Since these differences in interpretation often concern national regulation, the Commission will not interfere. Some MAs feel that even where the regulations do provide scope to accept certain claims, the AAs are interpreting them too narrowly.

IV. Tensions

During the interviews, several tensions became apparent. Some are inherent to auditing, while some are brought about by the system currently in place. These tensions influence the work of MA and AA,

31 Mendez and Bachtler (2011), p. 750.

32 View online at <http://ec.europa.eu/regional_policy/fr/policy/how/improving-investment/high-level-group-simplification/> (last accessed on 9 May 2017). Conclusions and recommendations on cross-cutting audit issues. 6th Meeting of the High Level Expert Group on Monitoring Simplification for Beneficiaries of ESI Funds (30 January 2017, p. 3).

33 Commissie van Goede Diensten, *pijnpunten in de controle van EFRO-2 subsidies in Nederland* (2015), p. 58.

their relationship and communication. These tensions may explain how problems between AA and MA come about and may give insight in how these could be resolved.

1. Tensions Due to Current System

- *Rules-based vs principle-based*: The AA and the EC employ more of a compliance- and rules-based approach in their work, which here means that they will check whether the rules are followed to the letter. Some MAs work more from a principle-based view, which means here that they look at what the regulation intends to achieve. MAs in for example Austria, Belgium, and the Netherlands work from a more principle-based approach.

In Austria the AA found an irregularity in public tendering: no tender had gone out. The MA argued that the cheapest good bought by accident, is still the cheapest.

- *Trust vs control*: Due to the small size of the programme in Luxembourg the MA is able to check 100 % of expenditure. In other Member States with larger programmes MAs do not have sufficient resources for this. Therefore, they can advise the beneficiaries on what action to take, but cannot check all expenditure. The relationship with beneficiaries and those in the audit/control pyramid relies more on trust. Ultimately, it is the beneficiaries – being at the bottom of the pyramid – who bear the audit/ control burden.
- *National vs European*: AAs are part of their respective national governments, usually the Ministry of Finance or, in several cases, part of the National Audit Office.³⁴ They audit national bodies - the MAs - at the request of their national government. The AA can be (partly) paid out of European funds through Technical Assistance, but this might be supplemented from the national government budget to cover actual expenses or even paid for entirely by the national budget. For MAs this is the same.³⁵ However, the AAs report to the EC. This creates tension in their situation: part of their national governments, but with allegiance to the EC. Whose interests do they serve? Those of their

Member State, of the citizen in the Member State, or those of the EU, or of the citizen of the EU?³⁶ Secondly, the Commission safeguards the EU budget, the MAs safeguard their State budgets, and the AAs are somewhere in the middle, but seem to be more loyal to protect the EU budget. Also the European Court of Auditors argues that corrections are primarily aimed at protecting the EU budget (in line with their mandate) and are ‘not focused on encouraging Member States and beneficiaries to comply with the rules’.³⁷ Given that the Commission protects the EU budget, they do not really seem to care whether the AA is too strict, in contrast to some MAs who are closer to the beneficiary and have to implement the corrections.

- *Hierarchy*: AAs and MAs do not have a hierarchical relationship in the system. In practice, however, AAs do have a position of power, since the MAs cannot appeal a finding. The AAs are supposed to include any dissenting opinions in their annual reports but this contains only a summary of the project reports. Therefore, it is doubtful whether disagreements will be sufficiently clear to the Commission. It is also doubtful whether it is in the Commission’s interests to look into this issue, particularly if the disagreement in question concerns national regulations. In Poland, the AA’s findings in the final report are always accepted, even when the MA does not agree: the AA is in a hierarchically higher position because of the status of their findings and the consequences for the beneficiary.
- *Accountability*: In the official structure, it is the Commission that applies financial corrections. These corrections are not officially aimed at the MA, but rather at the Member State itself, even though the MA is directly affected.³⁸ This means

34 As they are in Romania and Lithuania.

35 Radzyner, A., Frangenheim, A. and Todling-Schonhofer, H., *European Commission: Regional and Urban Policy, Co-financing salaries, bonuses, top-ups from structural funds during the 2007-2013 period* (2014), 9, 27, 34-38.

36 For more detailed research how this plays out in the Netherlands see Damen-Koedijk, M., *EU Cohesion Policy & Accountability: Coverage, Context & Costs in the case of ERDF in the Netherlands* (2016).

37 European Court of Auditors, *Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements* (Publications Office of the European Union 2014), p. 48.

38 Damen-Koedijk, M., *EU Cohesion Policy & Accountability: Coverage, Context & Costs in the case of ERDF in the Netherlands* (2016) p. 129.

that an MA cannot appeal against a finding of the AA to another body nor to the Commission itself. Only the Member State concerned can officially appeal a decision made by the Commission.³⁹ This can make an appeal more difficult, since other interests of the Member State also play a role, for example, hierarchy between ministries or the position and interests of the Member States towards the Commission. However, if the Commission blindly follows the recommendations made by the AA, it is the AA that is de facto applying corrections.

2. Tensions Due to the Nature of Audit

- *AA's independence*: The AA is an independent body to ensure its findings are not downplayed by external interests. At the same time, it is only supposed to check the regulations and refrain from interpreting them. This is a fine line. MAs do not currently have any means of appealing the AA's findings, except for the contradictory procedure with the AA. It makes sense that two bodies might differ in their interpretations of regulations, but the AA's independence makes it difficult to discuss these differences. Discussing a case ex-ante is impossible or at least very hard for several of the AAs examined in this study. It is argued that they cannot do so due to their independence and that, often, not all the details are known.
- *Professionalism*: Interviewees perceived a risk that auditors would feel the need to find mistakes and irregularities, in order to prove that they had done a thorough job. This risk would be strengthened by the prospect of another auditor, whether from Commission, from the ECA or in later years, finding an irregularity that has been missed the first time around. This may lead to audits that are too detailed. At the same time, auditors are professionals, bound by international audit and quality standards. This was apparent during the interviews: auditors stressed the importance of independent audit, of quality of their work, and of adhering to international standards. It is also argued that these

standards are often rule-based: thus that auditors must and will look at the letter of the law, instead of to the intention. This is a delicate and difficult balance for the auditor: making sure expenditure is correct without creating a disproportionate audit burden.

V. Legal Certainty Beyond Auditing

It is interesting to compare the audit system to another system, where legality is of utmost importance, but where we would argue there is a very different approach; namely the justice system. In administrative law if a case is brought to court, the plaintiff must indicate what rules have been violated and on what grounds the judge should decide. The judge is not supposed to investigate the entire dossier and look for any possible illegalities, but only fundamental rules. In the justice system, the realisation has been made that the rules to be applied should be known beforehand, and that parties have the right to defend themselves. Although direct comparison is not possible, we can observe that in the audit system this realisation has yet to be made. Auditors want to cover all possible risks in a project before giving a clean opinion, and this logic compels them to dig deep and in all directions. Unlike the judge, who looks only at the specific laws upon which the procedure has been based, the auditor is not bound to such a framework.

VI. Discussion and Conclusion

This paper presents the results of a study on the communication and relationship between Managing and Audit Authorities and on the possible effect on the legal certainty of the beneficiary and the audit burden. Through interviews with Managing and Audit Authorities a first insight is created in differences between several EU Member States for cohesion policy. This paper also intends to start a discussion about the system and problems due to this system. Therefore we invite everyone to engage in this discussion.⁴⁰

We already found one interesting conclusion from the High Level Expert Group (ESI-funds) who concludes: "Fostering trust among those who are controlled or audited and those who control or audit them, more focus on preventive actions, increasing

39 Ibid., p. 142.

40 Contributions to this debate, either examples, explanations, arguments for or against, can be send to: alex.brenninkmeijer@eca.europa.eu.

clarity of rules and legal certainty, ensuring accountability and quality of audit work, proportionality and more reliance on national systems will not only help beneficiaries, who - being at the bottom of the audit/control pyramid - are ultimately bearing the biggest burden, but will also result in lower level of errors." As well as trust, clarity and legal certainty, this highlights the need for proportionality. Proportionality is an important issue which was highlighted by interviewees, such as in Luxembourg, where the example was given of a declaration of a Christmas tree and lightbulbs of about 50 EUR being disapproved by an auditor, after having been approved under general costs by a MA and an AA.

We can conclude, firstly, that Managing and/or Audit Authorities in Austria, Belgium, and the Netherlands do report differences in interpretation of regulations between MA and AA. MA and/or AA in Bulgaria, Lithuania, Poland and Spain do not. These latter argued that all the discussions are resolved in the contradictory procedure. Luxembourg reported that there have been differences in interpretation with the European Court of Auditors.

Secondly, communication channels and quantity of communication between MA and AA are similar. It is, however, suggested that there are differences in the quality and tone of the communication. In the Netherlands and Austria, communication was not always reported as being optimal.

Thirdly, MAs and AAs report their relationship as cooperative and good. In Austria, Belgium, Poland, and the Netherlands some authorities also characterize the relationship as hierarchical. These authorities feel that the AA has the final word and is thus higher in hierarchy. In Austria, Belgium and the Netherlands the relationship was seen as tenuous or more precarious than in Bulgaria, Lithuania, Luxembourg, Poland and Spain.

Answering the research question, both the quality of communication and the relationship seem to be correlated to more differences in interpretation and thus the legal certainty. However, this is not straightforward in all cases. Poland does report a hierarchical relationship, but no interpretation differences. Several explanations may be offered for the differences between Member States. Firstly, Poland is a more hierarchical society in which Polish MAs see it as granted that the AA has the last word. Secondly, it was mentioned that in Bulgaria and Poland for example, corruption is seen as a problem. It is possible

that to prevent misuse of EU funds, the MAs are already quite strict and rules-based and thus work in a similar way to the AA. In Belgium and the Netherlands the MAs are more principle-based, which might create more interpretation differences with a rules-based AA. A third explanation may lie in the fact that the ERDF funds in Poland are quite large. Beneficiaries include large multinationals, while funds in Austria, Belgium and the Netherlands are small. This may be of influence. Furthermore, it may be possible, as it is for all Member States, that we have not found differences because we have not spoken with every actor.

Finally, it is hard to draw conclusions on the audit burden. Unfortunately, data on how much time is spent on audits was often not found, or not possible to compare. Several respondents did raise the question whether the time spent on audits is proportional to the results, namely a lower error rate. Further, some interviewees suggested that the time Audit Authorities have to audit a project is much more than Managing Authorities have to perform the first check on expenditure.

We feel it is also important to discuss our findings and conclusions a bit further. The system is an important part of this paper. We conclude that the system of audit and control in shared management does not facilitate resolution of interpretation differences between the MA and AA, at the cost of beneficiaries who are confronted with legal uncertainty. If the MA and AA cannot find a solution during the contradictory procedure, and the difference is in national regulation the Commission cannot resolve these differences. This is not illogical, as the Commission is not the responsible legislator. However, the Commission is responsible for EU budgetary implementation and thus cannot disregard an infringement to national legislation impacting EU funded projects. It does not matter whether this infringement is made by the beneficiary or by an AA when regulation is interpreted too strictly. When the Commission does not look at these cases, MAs are left with the feeling that the AA is actually making decisions instead of making recommendations to the Commission. The MAs cannot appeal a finding of the AA at an independent, other body. Only at the higher level of the Member State, of which both MA and AA are part, can a decision of the Commission be appealed. At this level of the Member State, more interests are at stake and elements involved, such as the relationship between in-

volved ministries, the position of a Member State to the Commission etc. which may influence the decision to appeal a decision of the Commission.

It is important to note that this study has not investigated whether the MA or AA is right or wrong in the examples quoted. It uses them to show that these differences lead to tensions, confusion and to legal uncertainty for beneficiaries. While beneficiaries must be corrected when intentionally misusing funds, the funds are created for beneficiaries to implement programmes and reach the goals set. Therefore, these beneficiaries must be facilitated to do so. However, we see that some beneficiaries would even no longer apply for EU funds, due to this uncertainty and the audit burden to prove the regularity of expenditure. And it is important to be aware of this. It is said that with five lawyers in the room, there will be five opinions. During this study, the same has been said about auditors. Therefore, there must be a good system to discuss these differences.

Not only the complexity of the system and the regulations were mentioned frequently in the interviews, but also the notion of trust. Some MAs men-

tioned working from trust, while some AAs are perceived as tending to work from distrust. Trust is necessary to build reliable funding systems. In general, if trust is low, the transaction costs are high and important players may give up. Not only for financial reasons, but also from the perspective of good intentions of professional people working on a daily basis in the management of EU-funds. Trust also relates to this professionalism. Professionals try to comply seriously with the rules of the system. This professional compass might be misled if – too strict and unpredictable – financial controls disregard the real needs in daily life of the correct use of EU funds. At the start of our study, a financial manager complained that it is becoming impossible for him to function well if distrust is eroding the system. This was in our eyes a quintessential signal which sparked our curiosity that led to this study. We hope that our findings – and the experiences of others – will enrich the discussion on the audit of EU cohesion policy. It is important to identify more and more precisely what factors might contribute to a credible balance between trust and control.