

INTERNAL AUDIT DIVISION



**ANNUAL OPINION ISSUED UNDER ARTICLE 62 (1) (d) (ii) OF COUNCIL  
REGULATION (EC) No 1083/2006 AND ARTICLE 18 (2) OF COMMISSION  
REGULATION (EC) No 1828/2006**

**February 2010**

To the European Commission, Directorates-General Regio and Empl

## Introduction

I, the undersigned, representing the Scottish Government Internal Audit Division (IAD), am responsible for examining the functioning of the management and control systems in the following operational programmes:

<b>Operational Programme</b>	<b>CCI Reference number</b>
Lowlands and Uplands Scotland ERDF	CCI No UK162po001
Lowlands and Uplands Scotland ESF	CCI No UK052po002
Highlands and Islands ERDF	CCI No UK161po001
Highlands and Islands ESF	CCI No UK051po002

There is a scope limitation as systems audits were not scheduled for the period under report.

Details of coverage of the 2007-2013 systems so far are set out in the accompanying Annual Control Report (ACR) which accompanies this opinion. The main coverage is the review of a Shadow Round (SR) set up to minimise the disruption caused by a late start to 2007-13 Operational Programmes (OPs). £12m was made available - £10m for Lowlands & Uplands Scotland and £2m for the Highlands & Islands to fund projects under Priority 1 in the European Social Fund (ESF) Programmes. The systems developed for managing and controlling the SR were used to form the basis of the systems eventually put in place for the mainstream programmes. These systems were also extended to the ERDF programmes operated in the two H&I and LUPS areas of Scotland.

A systems audit review of the SR confirmed that there were satisfactory systems of controls in place for project appraisal, approving and processing applications and the controls covering the claims processing and payment systems were operating effectively. Accordingly, on the basis of this coverage, and subject to the findings of future systems audits in these areas, I am content to extend that assurance to the systems currently in place.

The ACR also contains details of audits of the relevant systems in the previous programming period and which serve to provide assurance. These relate to all systems established to administer the SG's ERDF and ESF programmes i.e. MA, CA and project implementation /claim handling, audit trail, publicity and treatment of errors/irregularities. Consequently, I do not consider that the scope limitation has an impact on the expenditure declared so far.

As the first Statements of Expenditure were submitted in December 2009, no audits of operations were undertaken during the reference period.

## Opinion

This audit opinion sets out the level of assurance determined solely on the basis of systems audits carried out as detailed in the ACR. Therefore, based on the foregoing, it is my opinion that for the above-mentioned period, the management and control system established for the programmes detailed in above comply with the applicable requirements

of Articles 58 to 62 of Council Regulation (EC) No 1083/2006 and Section 3 of Commission Regulation (EC) No 1828/2006 and functioned effectively so as to provide reasonable assurance that Statements of Expenditure presented to the Commission are correct and, as a consequence, reasonable assurance that the underlying transactions are legal and regular.

### **CHANGES IN MANAGEMENT AND CONTROL SYSTEMS**

The management and control systems description received approval from the EC on 11 December 2009. There have been no changes notified to the Audit Authority as compared with the description provided pursuant to Article 71(1) of Regulation (EC) No 1083/2006.

### **CHANGES TO AUDIT STRATEGY**

The Audit Strategy previously noted to the EC is currently being re-drafted prior to being tabled for approval by the SG Finance and Sustainable Growth Audit Committee which is due to meet next in June 2010. Once that process is complete, the revised strategy will be submitted to the EC via SFC2007.

Signed by

**ALISTAIR MAY**

**Scottish Government**

**Head of Internal Audit Division**

**12 February 2010**

INTERNAL AUDIT DIVISION



**ANNUAL CONTROL REPORT 2009 UNDER ARTICLE 62 (1) (D) (i) OF COUNCIL  
REGULATION (EC) NO 1083/2006 AND ARTICLE 18 (2) OF COMMISSION  
REGULATION (EC) NO 1828/2006 JULY 2008 - JUNE 2009**

**FEBRUARY 2010**

## INDEX

Section	Title	Page
1.	<a href="#"><u>Introduction</u></a>	1
2.	<a href="#"><u>Changes in Management and Control Systems</u></a>	3
3.	<a href="#"><u>Changes to Audit Strategy</u></a>	3
4.	<a href="#"><u>System Audits</u></a>	4
5.	<a href="#"><u>Audits of Samples of Operations</u></a>	11
6.	<a href="#"><u>Coordination Between Audit Bodies and Supervisory Work of the Audit Authority</u></a>	12
7.	<a href="#"><u>Follow-up of Previous Years' Audit Activity</u></a>	14
8.	<a href="#"><u>Other Information (if Applicable)</u></a>	14
9.	<a href="#"><u>Table for Declared Expenditure and Sample Audits</u></a>	15

## 1. Introduction

*Indication of the responsible audit authority and other bodies that have been involved in preparing the report.*

This report has been prepared by the Scottish Government (SG) Internal Audit Division (IAD) in respect of the European Regional Development Fund (ERDF) and the European Social Fund (ESF) programmes in Scotland, as required under Article 62 (1) (d) (i) of Council Regulation (EC) No 1083/2006 and Article 18 (2) of Commission Regulation (EC) No 1828/2006. No other bodies have been involved in preparing the report.

*Indication of the 12 month (reference) period from which the random sample was drawn.*

The report covers the 12 month reference period from 1 July 2008 to 30 June 2009. As a Statement of Expenditure was not submitted to the Commission during 2008, a random sample has not been drawn. **Details in relation to the Audit Strategy are contained in Section 3 of this report.**

*Indication of the operational programme covered by the report and of its managing and certifying authorities.*

The operational programmes covered by this report are as follows:

<b>Operational Programme</b>	<b>CCI Reference number</b>
Lowlands and Uplands Scotland ERDF	CCI No UK162po001
Lowlands and Uplands Scotland ESF	CCI No UK052po002
Highlands and Islands ERDF	CCI No UK161po001
Highlands and Islands ESF	CCI No UK051po002

Within the SG responsibility for the work of the Managing Authority (MA) and Certifying Authority (CA) is assigned to the European Structural Funds Division (ESFD). To ensure adequate separation of responsibilities the MA and CA are functionally independent, each having separate teams. ESFD is organised as shown here.



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*Description of the steps taken to prepare the report.*

In the period under report, there was no Statement of Expenditure to or draw down of funds from, the Commission. Furthermore, the audit strategy was not formally approved by the Commission until 22 July 2009 and the Compliance Assessment of the Management and Control Systems (MCS) was not formally approved until 11 December 2009. IAD was the Compliance Assessment Body and as such, audit resource was devoted to developing and drafting the audit strategy and carrying out the assessment of the MCS. As the framework established to deliver the 2007-13 round of funding is fundamentally the same as that operated during the 2000-06 period, relevant earlier audit reviews (scope, working papers and reports) have been reviewed and assurances drawn, as appropriate. Full details are provided in Section 4 below.

On completion of the final draft, this report was passed to the MA, CA and ESFD senior

management to confirm content and factual accuracy.

## **2. Changes in Management and Control Systems**

*Indication of any significant changes in the management and control systems notified to the Audit Authority as compared with the description provided under Article 71 (1) of Regulation (EC) No 1083/2006 and of the dates from which the changes apply.*

A Letter of Acceptance from the Commission dated 11 December 2009 stated that the compliance assessment documents were considered acceptable. Since acceptance, no significant changes have been made to the MCS.

## **3. Changes to Audit Strategy**

*Indication of any changes that have been made to the audit strategy or are proposed, and of the reasons behind them.*

The Audit Strategy is attached for information. There have been no changes to the strategy per se since its approval by the Commission in July 2009, but the delays experienced in getting formal approval to the audit strategy and the compliance assessment has necessitated slippage in some of the planned reviews of the 2007-2013 programmes. These changes have been reflected in the attached copy.



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## **4. System Audits**

*Indication of the bodies that have carried out system audits, including the audit authority itself.*

System audits are undertaken by the SG's IAD. IAD provides an independent appraisal function to the Scottish Government as a whole.

*Summary list of the audits carried out (bodies audited).*

As per the Audit Strategy, no system audits were carried out in the reference period (but see below re coverage of the Shadow Round) due to delay in the timing of the SG's drawdown of EC funds. As stated in that strategy, however, there are a number of audits planned to commence in the financial year 2010/11 which have been agreed with the MA. The audits are as follows:

### **Managing Authority**

effectiveness of MA systems for ensuring that operations are selected for funding in accordance with OP criteria;

provision of guidance and support to IABs;

effectiveness of systems for verifying that co-financed products and services are delivered including checks required by Article 60(b) of EC Regulation

1083/2006;

effectiveness and reliability of the audit trail, in accordance with the requirements of Article 90 of Council Regulation (EC) no 1083/2006; and

accuracy and promptness of payments to beneficiaries on receipt of valid claims.

### **Certifying Authority**

effectiveness of systems for drawing up, certifying and submitting reliable and soundly based certified statements of expenditure and applications for payment to the EC (CA);

reconciliation of the aggregate amounts certified to the EC with the detailed accounting records and supporting documents (CA); and

effectiveness of systems for ensuring SEAS data reconciles to that held in Eurosyst.

### **Business Management and Support Team**

IAB contract compliance monitoring systems; and  
EUROSYS

### **Lowlands and Uplands Scotland IAB**

effectiveness of systems for selecting and approving projects, ensuring projects comply with applicable Community and national rules;

effectiveness of claims checking and processing;

effectiveness of systems for monitoring progress towards programme financial targets; and

effectiveness of IAB systems for ensuring the Global Grant Body and Strategic Delivery Body comply with the terms and conditions set out in Outcome Agreements.

The main coverage in the period under report is a systems audit review in June 2008 of a Shadow Round (SR) set up to minimise the disruption caused by a late start to 2007-13 Operational Programmes (OPs). £12m was made available - £10m for Lowlands & Uplands Scotland and £2m for the Highlands & Islands to fund projects under Priority 1 in the European Social Fund (ESF) Programmes.

The systems audited were developed for managing and controlling the SR and were used to form the basis of the systems eventually put in place for the mainstream programmes. These systems were also extended to the ERDF and ESF programmes operated in the two H&I and LUPS areas of Scotland. The audit objective was to provide assurance on the risk management control and governance arrangements in place for the SR, including compliance with EC financial control regulations.

## **Scope:**

evaluating activities of the Advisory Group (AG) arrangements and quality of Intermediate Administration Bodies (IAB) checking of applications

evaluating the quality of checking applied by IABs and MA to claims

reviewing the risk management arrangements in place to ensure achievement of objectives

evaluating the accuracy and reliability of the audit trail, including compliance with regulatory requirements

reviewing the arrangements for monitoring visits to IABs and projects

reviewing the quality of guidance provided to potential applicants by the IAB and the quality of guidance received from the MA.

## **Findings**

We ascertained the key risks to the above systems and the actual controls in place. We also considered the controls we would expect to be in operation and tested and evaluated the reliability of the actual controls against these.

Controls were found to be effective. There were satisfactory systems of controls in place for project appraisal, approving and processing applications, and the controls covering the claims processing and payment systems were operating effectively. Targets for submission of claims and progress reports were being met and there was a reliable audit trail of actions taken. Monitoring records reflected the claim details and local records are reconciled to monthly outputs from the SG's payments and accounting system (SEAS).

Our recommendations were intended to strengthen the existing controls in relation to financial control, procedural guidance and documentation. While they were of limited relevance to the administration of the SR, they were applicable to the administration of the mainstream programmes for the 2007-2013 programme period.

## **Audits of Operations**

In addition, now that the first drawdown of funds for these programmes has been submitted, we have the data necessary to commence a programme of visits under Article 62 of Commission Regulation (EC) No 1828/2006 (see Section 6 below).

## **Compliance Monitoring Group**

In the meantime a Compliance Monitoring Group has been set up with the following remit:

“to consider analyses of the results of desk-based checks and on-the-spot visits to projects and to identify problems that recur across projects. In doing this work, the CMG will have regard to the results of audit work carried out from time to time by DG Regio, DG Emploi, the ECA and Audit Scotland, as well as to the results of Art.62b checks made by the Audit Authority and checks made by the Certification Authority.

The CMG will encourage MAs and IABs to work together to eliminate recurrent problems at an early stage in communication with stakeholders and project sponsors. Recurrent problems that necessitate resolution at policy level will be referred to the Steering Group with a recommendation where possible.

The CMG will meet three times per annum, in February, August, and November. The first two meetings in each year will prepare findings for presentation to the H&I and LUPS Programme Monitoring Committees, and the November meeting will seek to resolve any compliance issues that stand in the way of meeting N+2 targets.”

The Audit Authority is represented on this group and has attended all three meetings which have so far been convened. The most recent meeting considered the findings of claims checking by the Intermediate Administration Bodies so far. The results of the checks are:

### **LUPS**

- Sponsors still including core organisational costs
- ESF Expenditure incurred before project start date
- Sponsors claiming expenditure outwith claim period
- Approximations being used in apportionment methodology
- Poor Audit Trails

### **HIPP**

- Most common issue is with items defrayed slightly outwith the PRC period.
- Small amounts removed for furniture that, although for training facilities, were not deemed eligible as were for basic chairs and tables and desks rather than teaching aids.
- Limited consultancy also removed where items deemed basic administration for the completion of claims once further detail was requested on the invoices. Applicant is to lodge an appeal, however.

The CMG constitutes a high level control in the Management and Control Systems generally and the outputs are being utilised to effect improvement where required. It is acknowledged that the checking system is still in its early stages, and the results so far can not be regarded as indicative of the effectiveness of management and control systems. Nevertheless, the results are encouraging in that the problems noted have been minor and effective (and corrective) action has been taken to improve the awareness of applicants of potential problem areas identified by the checks.

The data is also being used by the Audit Authority in determining risk areas and refining the audit plans for maximum effectiveness.

## Previous Programming Period

To assist in the formation of the audit opinion, evidence has also been drawn from the previous programming period. ESFD is well-experienced in the delivery of European funds and, in previous programming periods, has conducted all roles required by the 2007-13 Programme. This included the MA (including management of projects), the paying Authority (PA) and the Programme Management Executives (PMEs) responsible for programme delivery in specific territorial areas. Similar systems are now operational in respect of the 2007-13 Programmes and the same Division within the SG is responsible for programme delivery.

For the 2000-06 structural fund programmes, overall, we took assurance as to the effectiveness of controls applied by the implementing authorities during the course of the programming period. Where there was scope for improvement in the management and control systems, follow up reviews were conducted to confirm implementation of agreed recommendations and the impacts of the improvements in securing more effective management and controls. The following most recent system audits are indicative of the systems in operation:

**July 2005:** The audit objective was to provide assurance on the risk management control and governance arrangements in place, including compliance with EC financial control regulations in the Strathclyde European Partnership (SEP) for administering the West of Scotland Objective 2 ERDF and ESF Programmes.

### Scope:

the quality of procedural guidance

compliance with the Operating Agreement

the quality of checking applied to applications and the effectiveness of reporting arrangements

the quality of the claims checking process and compliance with EC and MA requirements

The quality of checks carried out under Article 4 of EC regulation 438/01

The accuracy and reliability of the audit trail

The accuracy and reliability of data underpinning the compilation and authorisation of Technical Assistance applications and claims.

## Findings

The systems of internal control were sound but we could give only limited assurance to the effectiveness of the audit trail in terms of its compliance with the EC requirements. In particular issues related to the reconciliation of summary accounts certified to the EC and verification of the allocation and transfer of the available EC and National funds. A subsequent follow-up review confirmed that all recommendations had been satisfactorily implemented and effective action had been taken to ensure the continuing reliability of the audit trail.

**September 2004:** The audit objective was to provide assurance on the risk management, control and governance arrangements in the MA and confirm compliance with EC financial control regulations.

**Scope:**

systems for setting, monitoring and reporting on aims, objectives, targets and outcomes

risk management

compliance with EC regulatory requirements as they relate to financial and operational control frameworks for the Objective 1, 2 and 3 areas

the effectiveness of systems for ensuring the eligibility of final beneficiaries, that they remain eligible for the duration of the action and that objectives are being achieved

compliance with requirements for checking, appraising and approving applications and for ensuring that decisions are fully documented

the effectiveness of systems for investigating and reporting irregularities and ensuring that they comply with regulatory requirements

the adequacy of procedural guidance.

**Findings**

Risk management, control and governance were sound, although there were a number of weaknesses that needed to be addressed to ensure full compliance with EC financial control requirements. The recommendations we made were designed to enhance the effectiveness of the control framework governing the MA's operations. A subsequent follow-up review confirmed that these recommendations had been satisfactorily implemented.

**November 2004:** The audit objective was to provide assurance on the controls established to manage the risk to efficiency and effectiveness of Community Initiative (CI) implementation and operation, and ensure compliance with EC guidelines.

**Scope:**

systems for setting and monitoring objectives and targets

compliance with EC regulatory requirements as they relate to the financial and operational control frameworks for the CIs

the effectiveness of systems for appraising and approving applications

payments procedures and the effectiveness of arrangements for ensuring that payments to final beneficiaries meet Divisional payment targets

the effectiveness of financial controls to ensure that N+2 targets are met

the completeness and accuracy of all declarations of expenditure sent to the EC  
effectiveness of IT/accounting systems

the adequacy of procedural guidance including currency, completeness and compliance with EC requirements.

## **Findings**

The arrangements for risk management, control and governance were sound, although there were some weaknesses that needed to be addressed to ensure full compliance with EC financial control requirements. The recommendations were designed to enhance the effectiveness of the control framework governing the MA's operations as they relate to financial and project progress monitoring. A subsequent follow-up review confirmed that these recommendations had been satisfactorily implemented.

**December 2003:** The audit objective was to provide assurance on the risk management control and governance arrangements in the PA and confirm compliance with EC financial control regulations.

## **Scope:**

the systems for setting and monitoring PA objectives and targets

the risks and controls within payments procedures

the effectiveness of the procedures for recording the results of claims checking and reporting findings to the MA

reviewing the IT/Accounting systems to determine whether the systems are adequate to provide reliable information as required by the EC

the procedures to ensure the completeness and accuracy of expenditure declarations

the effectiveness of systems for effecting recoveries and the associated accounting arrangements, including compliance with EC reporting requirements

the adequacy of and compliance with procedural guidance

## **Findings**

The systems of internal control including those relating to risk and governance were sound. A number of recommendations aimed at introducing more effective achievement of business and control objectives and effectiveness of the control framework governing the PA's operations were made and a subsequent follow-up review confirmed that these recommendations had been satisfactorily implemented.

## **5. Audits of Samples of Operations**

*Indication of the bodies that carried out the sample audits, including the audit authority.*

The Audit Authority (SG IAD) has direct management responsibility for the audit of operations and will ensure that audits are carried out on operations, on the basis of an appropriate sample, as required by Article 17 and Annex IV of Commission Regulation (EC) No 1828/2006, to verify expenditure declared.

*Description of the basis for selection of the sample(s).*

As a Statement of Expenditure was not made to the Commission until December 2009, it has not been possible to select a sample for audit. However, a sample is currently being selected as detailed in the Audit Strategy and in compliance with the requirements of Article 17 of Council Regulation (EC) No 1083/2006 and Article 62 of Commission Regulation (EC) No 1828/2006.

*Indication of the materiality level and, in the case of statistical sampling, the confidence level applied and the interval, if applicable.*

Not applicable.

*Summary table (see below point 9), broken down by programme and by Fund, indicating the eligible expenditure declared to the Commission during the calendar (reference) year (ending in the audit period), the amount of expenditure audited, and the percentage of expenditure audited in relation to total eligible expenditure declared to the Commission (both for the last calendar year and cumulatively). Information relating to the random sample should be distinguished from that related to other samples.*

Not applicable.

*Description of the principal results of the audits, indicating in particular the amount of irregular expenditure and the error rate resulting from the random sample audited.*

Not applicable.

*Indication of the conclusions drawn from the results of the audits with regard to the effectiveness of the management and control system.*

Not applicable.

*Information on the follow-up of irregularities, including revision of previously reported error rates.*

Not applicable.

*Indication of whether any problems identified were considered to be systemic in nature, and the measures taken, including a quantification of the irregular expenditure and any related financial corrections.*

Not applicable.

## **6. Coordination between Audit Bodies and Supervisory Work of the Audit Authority**

*Description of the procedure for co-ordination between different national audit bodies and the audit authority itself (if applicable).*

Not applicable.

*Description of the procedure for supervision and control applied by the audit authority.*

IAD has well developed audit methodologies which accord to the Government Internal Audit Standards (GIAS). A standardised approach to system audits is also available in accordance with the guidelines contained in Commission 'Guidance on a Common Methodology for the Assessment of Management and Control Systems in the Member States (2007-2013 programming period)'. Additionally, IAD has well developed quality assurance procedures. Such procedures include a review by the Audit Manager of all working papers for each audit before issue of reports. In addition, the IAD function is subject to periodic external reviews against the Government Internal Audit Standards.

Systems audits carried out to verify the effective functioning of the management and control systems are and will be:

Performed in accordance with the Audit Strategy developed by IAD. This is reviewed, and if necessary updated, at least annually;

The scope of individual assignments is agreed prior to the finalisation of the assignment Terms of Reference;

All phases of individual system audits are properly documented and available for review, as required;

Draft and Final Reports are released following review by and agreement of the Audit Manager. This includes concurrence on the assurance level provided against individual management and control systems;

Follow-up of the implementation of recommendations and corrective measures resulting from audit reports is agreed in plans approved by the relevant Audit Committee.

## **7. Follow-up of Previous Years' Audit Activity**

*Information on the follow-up of outstanding audit recommendations and on the follow-up of results of systems audits and audits of operations from earlier years.*

There are no audit recommendations for the current programming period.

## **8. Other Information (If Applicable)**

No further information is appropriate at the date of submission of this report.

9. TABLE FOR DECLARED EXPENDITURE AND SAMPLE AUDITS

Fund	Reference (CCI No)	Programme	Expenditure Declared in Reference Year	Expenditure in Reference Year Audited for the Random Sample		Amount and percentage (error rate) of irregular expenditure in random sample (3)		Other Expenditure Audited (4)	Amount of irregular expenditure in other expenditure sample	Total expenditure declared cumulatively	Total expenditure audited cumulatively as a percentage of total expenditure declared cumulatively
				(1)	(2)	Amount	%				
ERDF	CCI No UK162po001	Lowlands and Uplands Scotland Programme 2007-2013	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
ESF	CCI No UK052po002	Lowlands and Uplands Scotland Programme 2007-2013	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
ERDF	CCI No UK161po001	Highlands and Islands Programme 2007-2013	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
ESF	CCI No UK051po002	Highlands and Islands Programme 2007-2013	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil

1. Amount of expenditure audited.
2. Percentage of expenditure audited in relation to expenditure declared to the Commission in the reference year.

3. Where the random sample covers more than one Fund or programme, the information is provided for the whole sample.
4. Expenditure from complementary sample and expenditure for random sample not in reference year.

## INTERNAL AUDIT PLAN – 1 APRIL 2010 TO 31 March 2011

Directorate Business Area	Outline Scope of Audit
<b>European Structural Funds Division</b>	<p><b>Managing Authority</b></p> <p>Closure of the 2000-2006 European Structural Funds Programmes:</p> <ul style="list-style-type: none"> <li>South of Scotland European Regional Development Fund</li> <li>Highlands and Islands European Regional Development Fund</li> <li>Highlands and Islands European Social Fund</li> <li>West of Scotland European Regional Development Fund</li> <li>West of Scotland European Social Fund</li> <li>East of Scotland European Regional Development Fund.</li> </ul>
<b>European Structural Funds Division</b>	<p><b>Managing Authority</b></p> <p>Review of MA compliance with Article 60 of EC Regulation 1083/2006 in relation to project visits.</p>
<b>European Structural Funds Division</b>	<p><b>Managing Authority</b></p> <p>Applications processing and approval and guidance to Intermediate Administrative Bodies (IAB). Payments to beneficiaries (including reconciliation of the aggregate amounts certified to the EC with SEAS).</p>
<b>European Structural Funds Division</b>  <b>Business Support Team</b>	<p><b>Managing Authority</b></p> <p>MA systems for monitoring IAB compliance with contracts.</p>
<b>European Structural Funds Division</b>  <b>Intermediate Administration Bodies</b>	<p><b>All</b></p> <p>Audits of operations, per Article 62 of Council Regulation 1083/06.</p>

Directorate Business Area	Outline Scope of Audit
<b>European Structural Funds Division</b> <b>Business Support Team</b>	<b>Business Management and Support Team</b> International Standards Organisation 17799/British Standard 7799: Code of practice for Information Security Management (BS ISO/IEC 17799) will provide the framework for this review.

**INTERNAL AUDIT PLAN – 1 APRIL 2011 TO 30 SEPTEMBER 2011**

Directorate Business Area	Outline and Scope of Audit
<b>European Structural Funds Division</b>	<b>Review of the Certifying Authority</b> <ul style="list-style-type: none"> <li>• accuracy and reliability of statements of expenditure</li> <li>• accuracy and reliability of applications for payment to the EC</li> <li>• reconciliation of the aggregate amounts certified to the EC with the detailed accounting records</li> <li>• systems for ensuring SEAS data reconciles to that held electronically.</li> </ul>
<b>European Structural Funds Division and the East of Scotland European Partnership Ltd</b>	<b>Review of Lowlands and Uplands Scotland IAB</b> <ul style="list-style-type: none"> <li>• project selection and approval</li> <li>• claims checking and processing</li> <li>• financial monitoring</li> <li>• systems for managing the Global Grants Body (GGB) and SDB agreements.</li> </ul>
<b>East of Scotland European Partnership Ltd</b>	<b>Global Grant Body</b> Effectiveness of the GGB internal management and control systems.

## AUDIT STRATEGY

### 1. INTRODUCTION

#### 1.1 Identification of the audit authority responsible for drawing up the audit strategy and of any other bodies which have contributed. Explanation of the procedure followed for drawing up the audit strategy

The Scottish Government (SG) Internal Audit Division (IAD) within the Finance and Corporate Services Directorate as the Audit Authority is responsible for drawing up the strategy with respect to audits of Structural and Cohesion Funds for the programming period 2007-2013. No other bodies have contributed to the drawing up of the Audit Strategy as IAD is the sole audit body responsible for system audits, audits of operations and the closure declaration. The IAD is independent of the Managing Authority (MA), Certifying Authority (CA) and Intermediate Administration Bodies (IABs).

IAD prepared the Audit Strategy following discussions with senior line managers to identify the main areas of risk and on the basis of its experience of the 2000-2006 programming period. The requirements of Council Regulation (EC) Regulation 1083/2006 and Commission Regulation (EC) Regulation 1828/2006 (particularly Annex V) and the Guidance Note on the Audit Strategy issued by the European Commission (EC) (COCOF 07/0038/01) were also fully taken into account in the formulation of the strategy.

This strategy was drawn up by the Audit Manager (AM) responsible for audit of the European Social Fund and European Regional Development Fund within IAD. It was then approved by the Head of IAD (HIA). The HIA has delegated the day to day responsibility for continuous monitoring of delivery of the strategy to the IAD Audit Manager (AM) responsible for European Funds audit coverage. The HIA will seek regular reports from the AM to ensure that the strategic objectives are being met throughout the programming period.

The original strategy was approved by the Finance and Sustainable Growth Audit Committee (FSGAC) in April 2009. The FSGAC will monitor delivery of the audit strategy and plan, both of which will be reviewed annually to ensure they remain up to date and appropriate. Any significant changes will be approved by the FSGAC and notified to the EC in the annual control report. This version was tabled for FSGAC approval on 3 June 2010.

The linkages between the strategy and the annual planning process are explained further in section 4.3.

The SF Programmes are an integral part of the long-term audit plans for the SG and the audit objectives that IAD seeks to achieve, regardless of the source of funding, are applied equally to these Programmes. Government Internal Audit Standards (GIAS) also requires IAD to prepare a strategy that enables the HIA to provide the SG's Principal Accountable Officer (PAO) with an overall opinion each year on the effectiveness of the SG's risk management, control and governance arrangements. As well as demonstrating how the AA will provide assurance to the EC over the management of SF in Scotland, this strategy is aimed at providing similar assurance to the PAO.

The strategy provides for

- the audit cycle being determined by a risk assessment methodology
- risk based audit reviews in accordance with GIAS and standards set by the Institute of Internal Auditors (UK) (in particular IIA standards 2200, 2300 and 2400)
- reviews of compliance with EC and UK legislation
- reviews of operations to verify the effective functioning of management and control systems in accordance with Article 62 of Regulation 1083/2006
- evaluation of controls based on levels of compliance and substantive testing sufficient to form an opinion on their effectiveness and on the propriety and regularity of expenditure and the reliability of expenditure and accounting records.

## **1.2 Overall objectives of the audit strategy**

IAD's strategic objective in relation to the Structural Funds is to meet the requirements of Article 62 of Council regulation EC No 1083/2006 and Commission Regulation (EC) No 1828/2006-in particular Articles 16 and 17. This strategy sets out the audit coverage of the management and control framework operating within the structural fund delivery environment, including the audit methodology, sampling methodologies for audits of operations and the indicative planning of audits to ensure that the main bodies are audited and that audits are spread evenly over the programming period.

## **1.3 Functions and responsibility of the AA and other bodies carrying out audits under its responsibility**

IAD provides an independent and continuing appraisal of the SG internal control system in accordance with the objectives, standards and practices set out in GIAS and takes the action needed to provide the PAO with a continuing assurance that the SG's internal control systems are adequate and effective. In this regard, IAD uses the following range of audit approaches:

- Systematic audit comprising a comprehensive review of business systems and controls in which systems and risks are documented, and controls identified, evaluated and tested;
- Compliance audit where there is pre-existing confidence that controls are well designed, but effective operation of the controls is a material issue. Testing is directed at establishing whether controls are operating effectively;
- Key control testing focussed clearly on a small number of material or key controls;
- Systems development audit involving a phased review of developing plans and designs for new systems aimed at identifying potential weaknesses in control if the plans and designs go ahead as they are;
- Quality reviews for example of sponsored bodies Internal Audit Units;
- Special Reviews commissioned by management in response to specific circumstances;
- Consultancy/Service including commenting on draft procedural guidance and responding to management requests for advice on control issues;
- Governance Reviews including the arrangements underpinning the completion of certificates of assurance;
- Horizontal Audits involving evaluating central systems (e.g. Payroll and T&S) controls and undertaking transaction testing across different parts of the organisation;
- Crosscutting Reviews involving business systems and processes that cross organisational boundaries; and
- Follow-up Reviews directed at establishing the extent of implementation of agreed recommendations and the resultant impact on control.

No other bodies carry out audits under IAD's responsibility.

## **1.4 Indication of the independence of the AA from the MA and CA**

IAD is independent of the day to day management and control process of the MA and the CA, and has no responsibility for managing the Structural Funds Programmes. The HIA reports to the SG Director of Finance but is responsible to the PAO. These arrangements are set out in more detail in the Audit Charter agreed by the SG Audit Committee in February 2009.

## **1.5 Confirmation by the AA that the bodies carrying out audits under Article 62(3) of Regulation (EC) No 1083/2006 have the requisite functional independence**

IAD is responsible for carrying out all systems audits, audits of operations and closure for the 2007-2013 programming period. Consequently, the issue of the functional independence of bodies carrying out audits under Article 62(3) of Regulation (EC) No 1083/2006 does not arise.

## 2. LEGAL BASIS AND SCOPE

### 2.1 Indication of any national regulatory framework that affects the AA and its functions

There is no regulatory framework governing IAD functions in Scotland and, consequently, nothing of a statutory nature impacts adversely on IAD's ability to comply with EC regulations.

### 2.2 Indication of the period covered by the strategy

The overall objective is to meet the requirements of Article 62 of Council Regulation 1083/2006 and Commission Regulation 1828/2006 (particularly Articles 16 and 17). Accordingly, the strategy contains proposals for systems audit coverage and the audits of operations over the whole of the 2007-13 programme period up to closure.

### 2.3 Indication of the Funds, programmes and areas covered by the strategy

Operational Programme	CCI Reference number
Lowlands and Uplands Scotland ERDF	CCI No UK162po001
Lowlands and Uplands Scotland ESF	CCI No UK052po002
Highlands and Islands ERDF	CCI No UK161po001
Highlands and Islands ESF	CCI No UK051po002

## 3. METHODOLOGY

### 3.1 Indication of the audit methodology to be followed taking account of internationally accepted audit standards, audit manuals and other specific documents

IAD operates to standards set out in GIAS and those published by the Institute of Internal Auditors (UK). IAD's audit methodology is set out in its audit manual containing guidance on the standards and principles to be followed by IAD staff in the performance of their duties. This manual contains an overview of the organisational status of IAD and procedural guidance governing audit planning, fieldwork, reporting and follow-up.

## 4. AUDIT APPROACH AND PRIORITIES

### 4.1 Materiality thresholds for planning purposes and for reporting deficiencies

The maximum materiality level is 2%, in line with Annex IV of EC Regulation 1828/2006.

### 4.2 Indication of the types of audits to be carried out (system audits, audits of operations)

#### 4.2.1 Systems Audits

##### a) Specification of the body or bodies responsible for the audit work

IAD will be responsible for carrying out all systems audits.

##### b) Specification of the bodies to be audited

All the main implementing bodies will be subject to at least one systems audit during the life of the programme. The bodies to be audited are:

**Intermediate Administration Bodies (IABs)** - local delivery of the OPs has been formally contracted with 2 IABs, the Highlands and Islands (Scotland) Structural Funds Partnership Ltd, which administers the H&I programmes, and the East of Scotland European Partnership Ltd which administers the LUPS programmes.

**Global Grants Body (GGB)** - a Global Grants Programme (GGP) funded from the LUPS ERDF Programme has been introduced. Dumfries & Galloway Council will utilise its independent fund

and project management business unit to manage and implement the GGP for the period 1 January 2009 to 31 December 2011. The LUPS IAB will be responsible for monitoring GGB performance via an outcome agreement.

**Strategic Delivery Bodies (SDBs)** - funding has been earmarked for the delivery of key strategic projects by particular organisations designated as Strategic Delivery Bodies (SDBs). The SDBs are not IABs and they will be subject to similar monitoring and control to that applied to the GGB. The bodies concerned are:

For Priority 1 of the ERDF LUPS Programme: - Scottish Enterprise

For Priority 1 of the ERDF H&I Programme: - Highlands & Islands Enterprise

For Priority 2 of the ERDF Programme H&I and Priority 3 of the ESF H&I Programme: - University of the Highlands & Islands Millennium Institute.

#### **c) Indication of any horizontal issues to be covered by the system audits**

A risk assessment will be undertaken to prioritise the horizontal issues that will be subject to systems audits. These issues include public procurement, state aid, environmental matters, equal opportunities and IT.

The IT platform supporting administration of the funds delivery in Scotland is €UROSYS. This specific horizontal issue will be given priority for an audit at an early stage, and then periodically, as appropriate, during the course of risk-based audits of the management and control systems. International Standards Organisation 17799/British Standard 7799: Code of practice for Information Security Management (BS ISO/IEC 17799) will provide the framework for this work.

#### **d) Compliance Assessment**

Following completion of the Management and Control Systems (MCS) description covering the organisation and procedures of all parties involved in fund delivery, IAD will conduct a compliance assessment to ensure that it meets all the control requirements set out in EC Regulations. Thereafter, IAD will produce a report setting out the results of the assessment. The report and the MCS will be sent to the EC for approval. To ensure the necessary level of IAD independence and objectivity, the IAD element of the MCS has been independently assessed by the Welsh Assembly Government Internal Audit Division.

### **4.2.2 Audits of Operations**

#### **a) Specification of the body or bodies responsible for the audit work**

IAD is responsible for ensuring that the audits of operations are carried out in compliance with Article 62 b of EC Regulation 1083/2006. This will be done by means of the formal strategy attached as Annex 1.

#### **b) Specification of the criteria for determining the assurance level gained from system audits and reference to the documentation used for applying the sampling methodology**

The scope of work includes all bodies included in the MCS. As various elements of the programmes will be delivered by a variety of organisations, each will be assessed individually to ensure they are subject to an appropriate level of audit review. The frequency of individual reviews will be determined primarily by risk assessments, updated to take account of findings of system audits and audits of operations. The intention is to cascade the systems audit reviews to ensure that the high level functions are covered at the earlier stages of OP delivery and the results of these reviews will be used to determine the priority areas of coverage within the local delivery systems.

IAD will evaluate the reliability of the systems taking into account the results of systems audits so as to determine the technical parameters of the sampling, in particular, the confidence level and the expected error rate as set out in Article 17 of EC Regulation 1828/2006. In order to assess the reliability of the systems, IAD will follow the EC guidance on a common methodology for the assessment of management and control systems in the Member States.

Checking carried out in compliance with Article 62(b) of EC Regulation 1083/2006 is aimed at ensuring:

- clear definition, allocation and separation of functions between and within the MA, IABs and the CA
- effective systems for communicating guidance to all parties
- projects meet the selection criteria for the operational programme
- projects have been implemented in accordance with the approval
- management verifications comply with EC regulatory requirements
- projects fulfil all applicable conditions concerning functionality and use or the objectives to be attained
- expenditure declared corresponds to the accounting records and supporting documents held by the final beneficiary;
- expenditure declared by the final beneficiary is in compliance with Community and National Rules
- the public contribution has been paid to the final beneficiary in accordance with Article 80 of Council Regulation (EC) No 1083/2006
- Adequate audit trail
- effective preventive and corrective action on systemic errors
- adequate arrangements for keeping an account of amounts recoverable
- effectiveness of the arrangements for recovery of ineligible expenditure

The number of projects is not expected to reach a level suitable for the use of statistical sampling, at least in the early stages of the programmes, and sampling using a random selection basis will be adopted based on a random number generation process. This is intended to comply with the EC's Guidance note on Sampling Methods for Audit Authorities (COCOF 08/0021/01-EN). IAD will reassess its sampling methodology as the Programmes mature. The size of the sample will, in part, depend on the level of assurance gained from the systems audits. For random sampling, IAD will ensure that minimum sample sizes depending on the assurance gained from systems reviews will be used as follows:

<b>Assurance level from systems audits</b>	<b>Assurance from Systems Reviews</b>	<b>Confidence level</b>
Works well, only minor improvements required	High	Not less than 60%
Works, but some improvements required	Average	70%
Works partially, substantial improvements are needed	Average	80%
Essentially does not work	Low	Not below 90%

If the results from these levels of sampling indicate systemic issues, IAD will increase its sample size. If statistical sampling is implemented in future years, IAD will follow the grid of confidence levels recommended in the EC's Guidance Note on Sampling Methods for Audit Authorities.

The approach used will be considered as part of the annual review of the Audit Strategy, based on the known and predicted levels of activity. The following approaches will be adopted by IAD throughout the programming period:

### **Large Population**

IAD will adopt Monetary Unit Sampling as a statistical sampling approach to determine the sample size, if the population in any calendar year is sufficiently large to enable the use of such statistical sampling approaches. The confidence level will be determined on the basis of the above table and the expected error will be determined after taking into account the test of controls, the results of audit procedures applied in prior periods and the results of other substantive procedures. IAD will also take into account all guidance on sampling issued by the EC.

## **Small Population**

When the population in any calendar year is too small to apply a statistical sampling approach, IAD will group Operational Programmes in terms of quarterly claims and apply random sampling in line with the Commission Guidance note on Sampling Methods for Audit Authorities (COCOF 08/0021/01-EN). Where grouping of OPs still does not provide a sufficiently large population, IAD will analyse the population and decide whether stratification is applicable to separate operations with high value above tolerable misstatement (materiality) from operations with low value. For the high value items, a 100% audit will be appropriate whilst from the remaining population consisting of low value operations, an adequate percentage of the operations will be randomly selected, taking into account the reliability of the system and, if applicable, the technical parameters mentioned above. If stratification is not applicable, a random sampling methodology (such as random number generation through EXCEL) will be adopted taking into account the results of systems audits of the effectiveness of the management controls. If necessary additional operations will be selected to ensure that there is coverage of different types of operation, beneficiaries, and priority axes.

### **c) specification of the procedure for determining steps to be taken where material errors are detected**

In accordance with ISA 530, IAD will review all material errors and consider whether they are of a random or systemic nature, their cause and their possible effect on the programmes under review. IAD has followed the EC guidance and considers that a level of less than 2% materiality should be considered acceptable. Where errors detected during testing indicate a level of error below this level, no further testing may be necessary unless other information indicates otherwise, i.e. nature of the error.

Where error rates are identified which are greater than 2%, additional testing will be completed to establish if the errors identified are representative and systematic. Where errors are spread across all expenditure types, the selection of the additional sample would be performed using the same technique that was employed for the original sample (i.e. statistical / random) to allow for extrapolation if the results indicate this is appropriate.

If the error is limited to one category of expenditure or area then appropriate audit techniques will be used to determine the extent of the error. Where there are no indicators of a systemic issue, the financial corrections imposed will be limited to the individual items identified as irregular.

On a quarterly basis, IAD will calculate the error rates identified during the course of the on-site reviews. Error rates will be calculated by Programme and there will also be an analysis of common sponsors to identify issues across Programmes. The nature of the errors will be considered to identify any potential systemic problems, either within particular sponsors or across funds and programmes. This will include non-financial as well as financial errors.

Where high error rates are identified the AA will provide the MA with supporting documentation to allow the MA to implement suitable corrective action i.e. additional monitoring visits, suspension of payment or issuance of guidance where the issue is more wide spread.

Where the error rate exceeds the materiality level, IAD will analyse the results to establish in which programmes or parts of programmes the irregularities were detected and draw appropriate conclusions. In accordance with Article 17 of Commission Regulation (EC) No. 1828/2006, the results of the audits on the complementary sample, if any, will be analysed separately from those of the random sample.

### **4.3 Indication and justification of the priorities and audit objectives established for the whole of the programming period, explanation of the linkage of the risk assessment results to the audit work planned and indicative audit schedule of audit assignments for the forthcoming year provided in a table format**

Annex 2 assesses the level of risk currently associated with key areas and this will be updated on an annual basis with the results of the system audits completed within the reporting period. The effectiveness of the controls has been scored under a weighting system which allows an overall risk score to be calculated. The key criteria are those the EC expect to see operating in an

effective management and control system and the definition of how well the controls are operating is also based on EC guidance.

Tables are provided which show what scores attract low, medium and high levels of assurance with the higher the score being the higher level of assurance. Scores of 85%-100% are high assurance, 50%-85% medium assurance and 0%-50% low assurance. The current overall assessment results in an 80% assurance level and this breaks down to 80% for the MA, 70% for the IABs and 91% for the CA. This is based on the results of the MCS Compliance Assessment and, where relevant, experience of the effectiveness of systems for delivering the 2000-06 programmes.

An audit plan for the 2007-13 programming period is attached as annex 3. Following discussions with the Head of ESFD, senior managers in the area and the relevant finance team, an annual plan setting out the programme of reviews to be performed each year was approved by FSGAC. The plans have been agreed with the MA.

## **5. RISK ASSESSMENT**

### **5.1 Indication of the procedures followed, including the extent to which the results of previous audits of the bodies and systems have been taken into account**

IAD has developed a Risk Assessment Model (RAM) which allows auditable areas to be ranked according to their relative risk score determined by a formula which gives an appropriate weighting to a number of contributory factors, including the clients' own assessment of key risks, experience of the effectiveness of the management and control systems operated for the 2000-06 programme period and the outcome of the MCS Compliance Assessment. In developing the RAM, IAD has taken into account Standard 2010 of the Institute of Internal Auditors (UK).

Following the initial systems audits, risk assessments will be made of the MA/CA/IABs control systems and at the level of individual operations. The factors to be taken into account are inherent risk, control risk, financial risk, reputational risk and political risk. The risk assessment will be updated annually as part of the annual planning process and immediately following systems audits in the relevant areas taking into account the results of these individual audit reviews. Account will also be taken of the processes used by the MA and CA to identify and assess the risks that they consider could threaten the achievement of objectives.

### **5.2 Managing Authority, Certifying Authority and Intermediate Administration Bodies covered**

All bodies involved in the delivery of the structural funds will be covered. These are the MA and the CA, and all bodies identified in section 4.2.1 above. The GGB and the SDBs will also be audited at least once during the life span of the programmes although these are regarded as projects in their own right and, as such, are subject to controls by the relevant IAB.

### **5.3 Indication of the risk factors taken into account, including any horizontal issues identified as risk areas**

The scores will be re-calculated following each systems audit and in light of the findings of checks carried out under Articles 60 and 62 of regulation 1083/2006. The scores will, inter alia, constitute key criteria in formulating annual audit plans and prioritising individual reviews. Financial corrections will include the evaluation of extrapolated errors and will be based on the results of extrapolation. So far as horizontal issues are concerned, refer to section 4.2.1 (c) above.

### **5.4 Indication of the results through identification and prioritisation of the key bodies, processes, controls and programmes and priority axes to audit**

Section 4.3 above and annexes 2 and 3 attached refer.

## **6. RELIANCE ON THE WORK OF OTHERS**

### **6.1 Indication of the extent to which certain components are audited by other auditors and the extent of potential reliance on such work**

There are, currently, no plans for the involvement of any other auditors in the delivery of this strategy.

**6.2 Explanation of how the audit authority will ensure the quality of the work carried out by the other audit bodies, taking account of internationally accepted audit standards.**

Consideration may need to be given to employing audit technicians from external service providers to ensure that audits of operations are completed timeously. The IAD has substantial experience working with external service providers and if this course of action is adopted, IAD would be responsible for issuing the Terms of Reference and for supervising the quality of the work performed taking into account internationally accepted audit standards.

**7. RESOURCES**

**7.1 Indication of planned resources to be allocated, at least for the forthcoming year**

The table attached as Annex 4 gives an indication of the audit resource input planned up to September 2012. The data in respect of systems audits is authoritative, but that for the audits of operations remains speculative pending data from the CA in relation to draw downs from the EC.

The staff used to deliver the plan are very experienced in SF. The AM has over 8 years of SF experience in addition to extensive system audit and financial audit work. The audit team is headed up by a Senior Auditor with extensive knowledge of SF and over 10 years experience in systems audits.

**8. REPORTING**

**8.1 Indication of internal procedures for reporting, such as provisional and final audit reports, and of the right of the body audited to be heard and to provide an explanation before a final position is taken.**

**Systems Audits**

At the end of each audit, IAD will prepare a draft audit report and send it to the relevant MA. A standard report template will be used which will include an executive summary setting out the audit scope and objectives, summary of main findings and overall conclusion/opinion. The report will be copied to the Head of ESFD and the Head of the CA. Within one month of the receipt of the report, the MA will send written comments to IAD or a meeting will be convened to discuss the report contents. Thereafter, IAD will finalise the report with an action plan for implementing the agreed recommendations, issue it to recipients of the draft report and the relevant EC Directorate and make arrangements for following up implementation of the agreed recommendations at an appropriate time (normally at the earliest date following the final agreed target date for implementing the agreed recommendations). The agreed action plan will provide the basis for the follow-up review.

An annual report to the FSGAC will provide a summary of all the reviews carried out during the course of the year and an opinion on the overall effectiveness of control supplemented during the course of the year with progress reports including the status of agreed recommendations

The criteria for the provision of opinions are as follows:

<b>Substantial Assurance</b>	Risk and control systems are generally sound and well managed.
<b>Reasonable Assurance</b>	The management or operation of risk and control systems is mainly satisfactory, but requires some improvement
<b>Limited Assurance</b>	There are fundamental weaknesses in the management and/or operation of risk and control systems.

## **Audits of Operations**

Reports of on the spot visits will issue within two weeks of the wash-up meeting with the project sponsor and the MA. The MA will confirm whether or not it agrees with the recommendations in the report. If IAD and MA fail to agree on the disposal of any recommendations, the report and all correspondence relating to it will be referred to the Head of ESFD who will act as final arbiter.

## **Annual Control Report**

Article 61 of Regulation 1083/2006 requires Member States to report to the Commission, specifically the Director General of the Regional Policy DG (DG REGIO) on an annual basis, by 31st December. To comply with this requirement, the HIA will provide an Annual Control Report (ACR) and Opinion summarising audit activity covering the previous 12 month-period ending on 30 June of the year concerned. In addition to setting out any material deficiencies identified in the management and control systems subject to audit review, the report will contain:

- any changes in management and control systems
- any changes to the audit strategy. In adhering to this requirement, IAD will report to the EC whether audit activity as described in the audit strategy is being carried out as planned, whether the audit assurance strategy remains appropriate or requires amendment.
- details of any systems audits and/or audits of operations completed in the reporting period
- follow-up of previous year's audit activity
- the amount of irregular expenditure and the error rate resulting from the random sample audited
- declared expenditure
- any other relevant information

Any changes to the MCS (first bullet point) are the responsibility of a nominated officer in the MA. As part of the report drafting process, this officer will be asked to provide a note of all changes to the description which have taken place in the year in question. All such changes will be reflected in the MCS description residing in SFC2007, and a reference to this effect will be included in the ACR. Details of declared expenditure (fifth bullet point) will be sought from the CA and will be subject to check as part of the Article 62 1 (b) checks. The results of this coverage will be included in the ACR along with details of any adverse findings which may impact on the accuracy of financial data. The remainder of the ACR will be completed using data available from Eurosyst and the audit programme carried out during the course of the year.

The ACR will be accompanied by an Opinion commenting on compliance with the relevant regulatory requirements (Articles 58-62 of Council Regulation (EC) No 1083/2006 and Section 3 of Commission Regulation (EC) No 1828/2006); whether or not the management and control systems functioned effectively over the period covered by the ACR; and provide reasonable assurance that statements of expenditure are correct and, as a consequence, give reasonable assurance that the underlying transactions are legal.

## **9. PROGRAMME CLOSURE**

The purpose of the Final Declaration is to provide an opinion on the validity of the payment claim and the legality and regularity of underlying transactions in the final statements of expenditure and final control report. The declaration will be submitted to the Commission no later than 31st March 2017 and will accord with the requirements of Article 62(1) (e) of Council Regulation (EC) No 1083/2006, and Article 18(3) and the model provided in Annex VIII of Commission Regulation (EC) No 1828/2006. The final declaration will be based on all work carried out under the responsibility of IAD and it will include details of the risk methodology, the MA, CA and IABs covered by the risk assessment and an indication of the risk factors taken into account.

**STRATEGY FOR AUDITS OF OPERATIONS UNDER ARTICLE 62 1 (B) OF COUNCIL  
REGULATION 1083/2006**

## **INTRODUCTION**

1. This document has been drawn up by the Internal Audit Division (IAD) of the Scottish Government (SG). IAD provides the functions of the Audit Authority (AA) as prescribed in Article 59 (c) of Council Regulation (EC) No1083/2006.

## **AUDITS OF OPERATIONS**

2. Article 62 1 (b) of Council Regulation 1083/2006 states that the AA of an operational programme shall be responsible for ensuring that audits are carried out on operations on the basis of an appropriate sample to verify expenditure declared. The audits shall verify that:

- a) Operations meet the selection criteria for the operational programme, have been implemented in accordance with the approval decision and fulfil any applicable conditions concerning functionality and use or the objectives to be attained;
- b) expenditure declared corresponds to the accounting records and supporting documents held by the beneficiaries;
- c) expenditure declared by the beneficiaries is in compliance with Community and national rules; and
- d) the public contribution has been paid to the beneficiaries in accordance with Article 80 of Regulation (EC) No 1083/2006.

3. The audits on a sample of operations shall be planned, performed and reported in accordance with the guidance contained in the attached fieldwork document. This also contains standard fieldwork documentation which provides for a programme of testing, completion of which is aimed at providing an opinion on performance against the aims set out in 2 a) to d) above.

4. The audits will also be used to provide an indication of the effectiveness of the checking carried out by the MA teams and the IABs under Article 60(b) of Regulation (EC) No 1083/2006. It is also intended that the results of the checks will be reported to the Compliance Monitoring Group.

## **Sample Selection**

5. In line with the EC's Guidance note on Sampling Methods for Audit Authorities (COCOF 08/0021/01-EN), for large populations, Monetary Unit Sampling (MUS) will be used to determine the sample size. The confidence level will be determined on the basis of the following table and the expected error will be determined after taking into account the test of controls, the results of systems audits and the results of other substantive procedures.

<b>Assurance level from systems audits</b>	<b>Assurance from Systems Reviews</b>	<b>Confidence level</b>
Works well, only minor improvements required	High	Not less than 60%
Works, but some improvements required	Average	70%
Works partially, substantial improvements required	Average	80%
Essentially does not work	Low	Not below 90%

6. When the level of expenditure/number of claims in drawdowns for a particular year (July to June) is too small to justify the application of MUS, is not expected to reach a level suitable to justify adoption of a formal sample selection methodology, a random selection basis will be adopted. The approach will in any event, comply with the EC's Guidance note and the methodology (and sample sizes) will be re-assessed in light of the level of assurance gained from systems audits.

### **Pre-Visit**

7. Once the projects to be visited have been identified, Eurosyst will be interrogated for details of the application, award letter and acceptance, previous claim details. If necessary, additional data will be sought from the relevant Management Authority (MA) team and a formal letter will be sent to each of the applicants setting out the time and date of the proposed visit; details of auditors involved; the items selected for checking; the documentation and records that should be made available for inspection and, where appropriate, specific arrangements for a site visit. Normally, 6 weeks notice will be given. The MA and Intermediate Administration Body (IAB) may participate in the visits if desired.

### **During the Visit**

8. The attached fieldwork document covers the areas that may be examined during the course of the visit. Third party assurances are not sufficient by themselves and the visiting team must examine original documents. The fieldwork document acts as an aide memoir and should be completed during each review.

### **Post Visit**

9. The team will:

- ensure that any outstanding information from the project is received;
- review the information gathered and, if necessary, discuss with the MA and /or the Certifying Authority (CA);
- formally report findings to the project and the MA;
- record the details in Eurosyst; and
- review the effectiveness of MA follow-up actions.

### **Analysis of Findings**

10. Analysis of the findings of the visits will be used to determine the effectiveness of the management and control systems and the need for action to be taken in relation to actual or potential systemic weaknesses. Where the number of detected irregularities appears to be high or where systemic irregularities have been detected, additional visits may have to be carried out to confirm the accuracy of the findings from the original sample. The results of the audits on any complementary sample shall be analysed separately from those of the random sample. Conclusions on the basis of the results of the audits will be communicated to the MA, the Compliance Monitoring Group, and the EC (in the Annual Control Report and opinion).

### **Programme Closure**

11. The findings from the audits of operations will feed into the declarations to be provided at programme closure.