Audit of financial instruments in the 2021-2027 programming period – Follow-up Q&A webinar

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#ficompass

European Commission

European Investment Bank

General questions (1/4)

- **#1 Where can I find the methodology?**

•https://www.fi-compass.eu/library/other/guidance/audit-methodology-auditing-financial-instruments-programming-period-2021

•https://www.fi-compass.eu/sites/default/files/publications/audit-methodology_FIs-2021-2027-annex_en.pdf

- **#2 Does the methodology also apply to the previous programming period since the methodology has shifted significantly?**

The Audit Methodology for auditing FIs subject of this webinar is applicable only for 2021-2027 programming period.

- **#3 Does this methodology apply also to the funding under the RRF/ NRRPs?**

No, it applies only to Cohesion policy.

- **#4 Is the methodology applicable for EAFRD as well? Will the COM use the same methodology?**

It is mandatory only for the Commission auditors within the Cohesion policy; nevertheless, other Commission services could use this audit methodology as a reference.

General questions (2/4)

- **#5 What are the main differences compared with the previous audit methodology (14-20)?**

One of the most important changes consists into the fact that the verifications on eligibility do not include any longer 'the actual use for intended purpose' but an 'evidence that the support provided through the financial instrument is to be used for its intended purpose'.

Another important change is about "No more payments in tranches". Payments by the Commission are made based on reimbursement of expenditure incurred (except for advance in the first payment application).

Other changes include:

- ✓ Reduced the minimum requirements for the Ex-ante assessment as the market assessment is part of the programming;
- ✓ Continuation of the FI across two consecutive programming periods;
- ✓ More flexible combination of grants with FI in one FI operation, the grant component can take any form (e.g. capital rebate) and also be paid to final recipients;
- ✓ Simplified rules for MCF that should be performance based.

General questions (3/4)

- **#6 What is meant by single audit? Can we rely on the verifications by MA?**

(Art 80) Auditors shall first use the information and records at MA level and only request additional documents and audit evidence from the bodies implementing FIs where this is required to support robust audit conclusions.

The application of single audit principle reduces the administrative burden by avoiding duplication of audits and management verifications of the same expenditure declared to the Commission.

- **#7 To what extent should all the provisions of this methodology be encompassed in the Management and Control Systems of the MS?**

This audit methodology is designed for the Commission (DAC) auditors, but it can be used by AAs when designing their audit programme. The audit methodology gives the MA/IBs legitimate expectations.

General questions (4/4)

- **#8 Can AA or MA controls exceed the limits of the CPR? For example, by requesting visits to final recipients**

No, audits or management verifications can **NOT** be performed at the level of the final recipients. The bodies implementing the FI shall monitor final recipients in accordance with their normal banking practices.

- **#9 The audit methodology 2014-2020 had a very useful annex on the functions and responsibilities of each actor. Can we rely on it in 2021-2027?**

Section 3 “Management and Control Framework for FI” in the Audit Methodology for 2021-2027 explains the different functions and responsibilities. Otherwise, the annex "Management and control responsibilities" to the audit methodology 2014-2020 can be used by analogy in the current period 2021-2027.

- **#10 It's clear that no FI audits at the level of EIB. Should AAs audit expenditures of FI implemented by EIB through intermediaries at investment level? CPR article?**

Art 81(3) states that AA shall carry out system audit and audit of operations (Art 77, Art 79 or Art 83) at the level of bodies implementing the FI (or bodies delivering the underlying new loans).

Audit and the ex-ante assessment (1/3)

- **#11 Are there any requirements for the institution preparing the ex-ante evaluation?**

The ex-ante should be prepared under the responsibility of the MA according to Article 58(3) of the CPR. The content of the ex-ante is framed in this article. There are no formal requirements for the institution preparing the ex-ante. This can be the MA itself, internal or external body, such as the National Promotional Bank. We remind also that the ex-ante can be reused from previous programming period.

The important point is that the MA remains ultimately responsible for the ex-ante which at the end serves as a management tool in order to better design the instrument.

- **#12 Can ex-ante assessment be prepared by MA?**

Yes, the ex-ante assessment can be prepared in-house by the MA.

Audit and the ex-ante assessment (2/3)

- **#13 Are the auditors allowed to put the methodology or the results of the ex-ante in question?**

No, they are supposed to check:

- Whether it includes the minimum requirements under Article 58(3) of the CPR;
- Whether it was performed before the MA makes programme contributions to the financial instrument (Article 58(3) CPR);
- Whether the amounts of programme contribution, the estimated leverage effect, the financial products or the target group are in line with the ex-ante assessment. In case of inconsistencies/deviations, obtain justifications from the MA (Article 58(3) CPR).

- **#14 Is it that the auditors are not expected to reperform the ex-ante or that they should not be doing it?**

Yes, it is, the auditors are not expected to reperform the ex-ante assessment.

See above!

Audit and the ex-ante assessment (3/3)

- **#15 Is that possible to deviate from the ERDF rate recommended by the ex-ante assessment ?**

Deviations from the ex-ante are possible, however they should be duly justified and documented. It is not needed for the ex-ante itself to be amended but there should be a document to explain why the FI is different from the proposed one.

- **#16 Is a communication to the monitoring committee of the justification of the deviation of the EEA (ex-ante assessment) enough to assure that the completeness is ok ?**

Yes, this should be enough, a written communication to the Monitoring Committee.

- **#17 Is the update of the EEA something that can be done by the MA ?**

Yes, it could be done by MA.

Implementation – Selection and Funding Agreement (1/4)

- **#18 Can you tell us where to find the checklist for the verification of the selection of the body implementing the FI covered by article 12 of Directive 2014/24/EU ?**

According to Article 59(3)(d) CPR, MA may directly award a contract for the implementation of a FI to bodies entering under the scope of Article 12 of Directive 2014/24/EU (PPD) - "Public contracts between entities within the public sector". MAs remain accountable for the design and implementation of the necessary controls to ensure the compliance with the provisions of the PPD.

The auditors use the Checklist to the audit methodology 2021-2027 (point 11.b) and perform the following verifications (that can be extended, if necessary, with additional checks based on the provisions of Art 12 PPD):

✓ Check whether the conditions for inhouse award are complied with:

a) *Control of CA over the "in-house" entity (e.g. development bank);*

b) *>80% activity in tasks entrusted by CA/another legal person controlled by CA; and*

c) *Ownership of the "in-house" entity (i.e. no (decisive influence of) direct private capital participation)*

✓ Check whether the conditions for inter-administrative cooperation complied with cf. Art 12(4) PPD.

Implementation – Selection and Funding Agreement 2/4

- **#19 Art. 7 Reg. No. 480/2014 (Criteria for the selection of bodies implementing FI) does not exist anymore. Are these criteria however still applicable in 2021-2027?**

This article is not applicable anymore. If MAs consider necessary, the examples of selection and award criteria contained in this article can still be used for inspiration.

- **#20 Should we include in the Funding Agreement both investment strategy (IS) and business plan (BP)? If yes, what is the difference between them? Could you elaborate on them?**

The IS is a key document that sets out the policy and commercial objectives of the financial instrument. The BP describes the way in which the financial instrument will be implemented. The two documents are required under Annex X for FI implemented both directly by MA (Article 59(1) CPR) and under the responsibility of the MA (Article 59(2) and (3) CPR). For more info: Funding agreement | fi-compass.

Implementation – Selection and Funding Agreement 3/4

- **#21 Should the differentiated treatment of investor be stated in the Funding Agreement / Investment Strategy and if so, in what way?**

Yes, differentiated treatment could be stated in the Investment Strategy (IS) or in other parts of the funding agreement.

The auditors will verify whether the use of differentiated treatment of investors is in line with the IS. (The level of differentiated treatment should not exceed what is necessary to create the incentives for attracting private resources. This level of incentive is determined either in the process of selecting the fund managers, in a competitive process or through an independent assessment, and never through an assessment provided by the body, which benefits from this differentiated treatment (Article 61 CPR)).

Implementation – Selection and Funding Agreement 4/4

- **#22 In the case of continuation, if the body implementing a FI was selected within PP rules, must the HF ensure that PP rules are respected for the modification of contracts? What happens when PP rules are not respected?**

Article 68(2) CPR does not create any derogation from the public procurement rules at EU or/and national level. In case of continuation, the existing funding agreement is to be updated.

Regarding at which level the continuation of a holding fund model should happen: the continuation applies to the financial instrument.

In case of continuation, it depends whether the original selection procedure of a body implementing FI had foreseen the option of adding extra resources to the financial instrument. If yes- then no new procedure, if no- the selection procedure has to be repeated (for reference Article 72(1) of the public procurement directive defines the rules for the modification of contracts).

Audit and body implementing the FI (1/5)

- **#23 Should the AA also check if the interest rate agreed is received and the repayment by the final beneficiary is made and received?**

Audit work should ensure that the resources returned attributable to the Funds are managed in accordance with the provisions of Article 62 CPR and are recorded in a separate account in accordance with the provisions of Article 59(9) CPR.

The management of the repayment of the interest and the capital is the task of the body implementing FI as agreed in the funding agreement. Auditors should verify that the body implementing FI applies its controls and performs its tasks according to the funding agreement. It is the business of the financial intermediary to ensure that the loan and the interest is repaid, and not the task of the AA.

Audit and body implementing the FI (2/5)

- **#24 Are auditors entitled to check how the financial intermediary is monitoring actual use of funds?**

If the "actual use of funds" refers to **the intended use of the support,** the bodies implementing FIs are expected to check the intended use of support at the time the support is granted. The auditors are entitled to audit their checks.

The Funding Agreement must clearly indicate the audit requirements, including provisions for access to documents to be kept at the level of financial intermediaries, in accordance with Annex X.1(e) CPR.

Audit and body implementing the FI (3/5)

- **#25 How should controls over bodies implementing FIs be implemented once there are no more tranches and financial instruments payments are made mainly as the loan is signed.**

The management verifications should be proportionate and based on risks (e.g. FI implemented through a well-functioning body implementing a HF might be less risky due to the additional layers of controls implemented by these bodies according to the FA). For example, it could be that the MA thanks to the arrangements put in place and based on the result of its first verification/or audit results consider that the operation is not risky and decides not to control any transactions (the check on the payment claim could be limited to reviewing the list of transactions without requesting any supporting documents).

The MA will perform administrative and on-the-spot verifications, taking into account the monitoring arrangements agreed in the funding agreement.

The fact that there are no more tranches does not affect the monitoring by the MA of the implementation of the FA. Once the MA receives the payment claim from the beneficiary (i.e., the body implementing the HF or SF, as appropriate), this is in general accompanied by a list of transactions justifying the payment claim (e.g. information like the name of the final recipient and its status, the object of the loan, the amount).

Audit and body implementing the FI (4/5)

- **#26 How will the actions of [bodies implementing FIs, HF and SF)] in the collection of unpaid loans be verified? When can the [SF] end the collection of an unpaid loan (end of the programme?)**

The CPR does not regulate the verification of the recovery procedures for unpaid loans as this is part of the normal banking activity. The rules on recovery should be agreed between the MA and the bodies implementing the FIs and they may be part of the funding agreement.

Audit and body implementing the FI (5/5)

- **#27 Can the body implementing FI outsource the closure of contract with final recipient to a subsidiary company?**

If the question refers to the fact that the body implementing the FI transfers the management of the portfolio to another subsidiary for the closure of the portfolio, this is possible if the MA agrees so.

If the question refers to the provision of factoring services (or guarantees for factoring services) by the financial instrument, this is not eligible under CPR rules. The provision of factoring services is not aligned with the purpose and objectives of financial instruments support:

- ✓ factoring services would not aim at supporting new investments in final recipients nor at covering the risk of default of the factor's client (e.g., SME) as such but rather at covering the factor's risk that the debtor of its client fails to meet its payment obligations.
- ✓ Article 59(7) CPR requires that the final recipients receiving support from financial instruments are selected with due account of the programme objectives and the potential for the financial viability of the investment as justified in the business plan or an equivalent document. The selection of final recipient shall be transparent and shall not give rise to conflict of interest. These requirements reflect one of the core principles for the provision of the financial instrument support, the purpose of which is to finance a concrete investment.

Management costs and fees (1/3)

- **#28 Could you elaborate on the reimbursement of management costs and fees on the basis of performance?/ How the audit will check the criteria of "performance-based" CPR 68(4) in case of financial intermediaries selected via tender?**

First paragraph of Article 68(4) CPR specifies that management fees should be performance based.

The MA has to agree with the bodies implementing the FI, what are the performance criteria to be taken into account for the remuneration of the fund manager, depending on the scope of the financial instrument.

The auditors will verify if:

- ✓ the performance fee structure includes performance criteria,
- ✓ the outcome of the selection process is translated in the funding agreement ,
- ✓ the calculation methodology agreed in the funding agreement is correctly applied when the fund manager is remunerated,
- ✓ the fund manager has been remunerated before the management fees are declared as eligible expenditure in the payment application.

Management costs and fees (2/3)

- **#29 Management fees : What is the difference between the audit trail for management fees and management costs ? And how justify this difference during and audit ?**

Management costs are linked to incurred expenditure; the auditors will look for an evidence proving the calculation of these costs.

Management fees are to be audited based on the provisions in the Funding Agreement (did they use the correct % and apply to the correct basis), including compliance with the thresholds in Article 68(4) CPR in case of direct award of contract.

The auditors will also check that the MCF have been paid.

All these checks can be done in the final accounting year.

Management costs and fees (3/3)

- **#30 The body implementing the FI was selected by the MA through a direct award Art. 59 (3). The body implementing the FI (holding fund) selects bodies (that conclude the contracts with the final recipients) through a competitive tender.**

  Are the management costs of the body selected through 59 (3) AND The bodies selected through the tender eligible expenditure?

Yes. When the body implementing a HF is selected through direct award cf. Art 59(3) CPR, the MCF shall be up to a certain % of the total contribution disbursed to final recipients (5% for loans/guarantees and 7% for equity/quasi-equity).

When the bodies implementing SF are selected through a competitive tender, the amount of MCF shall be established in the funding agreement and shall reflect the result of the competitive selection.

Audit and final recipients (1/4)

- **#31 Please clarify what is meant by, "final recipients are not part of audit". We have seen it as a standard practice to ask final recipients to submit e.g. account statements (in equity)**

CPR defines that both management verifications and audits have to be conducted at the level of bodies implementing the FI (bodies delivering the underlying new loans). It implies that no verifications / audits can be conducted at the level of final recipients. This does not mean that the final recipient does not need to provide the necessary documentation to the bodies implementing the FI when requesting the support.

All the documentation required for audit trail cf. Annex XIII CPR should be maintained at the level of beneficiaries (bodies implementing FI), including all the necessary evidence collected from final recipients. For example, in case of equity instruments, collecting the accounts statements from final recipients is compulsory.

- **#32 When you say that final recipients should not be audited, do you mean the part that Audit Authority audits (audit of the process), or also checks done by MA?**

The rule applies to both management verifications - Article 81(1) CPR, and audits – Article 81(3) CPR.

Audit and final recipients (2/4)

- **#33 How can the body implementing the FI make sure, thanks to the contract, that the final recipient will execute the obligation of visibility (art 50 1c)**

According to point (1)(n) of Annex X to the CPR, the funding agreement between the managing authority and the bodies implementing FIs must include the '*terms and conditions to ensure that through contractual arrangements final recipients comply with the requirements of displaying of durable plaques or billboards in accordance with point (c) of Article 50(1), and other arrangements to ensure compliance with Article 50 and Annex IX for the acknowledgement of support from the Funds*'. The bodies implementing FIs would carry out the monitoring of those terms and conditions accordingly (e.g., by receiving pictures or screenshots).

Audit and final recipients (3/4)

- **#34 Art 50 visibility requirements: Final recipients of FI shall display durable plaques or billboards clearly visible to the public, that present the emblem of the Union etc. How can an SME that has its premises and physical investments (e.g. new IT-Structure, new 3-d printer etc.) not visible for the public display something that is clearly visible to the public?? This creates a headache for SMEs that repay a loan from the private banking sector with market interest rates.**

  Working capital is exempted from Art. 50 (1). What about SMEs or Start-ups that have mostly (> 50%) working capital and some physical investment (IT-equipment, a car, a small machine etc.)?

In the context of financial instrument, the threshold in Article 50(1)(c) CPR refers to the investments at the final recipient level. Therefore, where operations are supported by ERDF and CF, final recipients should display durable plaques or billboards clearly visible to the public where the total cost of the investment exceeds EUR 500 000. The provision of Article 50(1)(c) CPR should be considered in relation to the total cost of the investment as set out **in the respective contractual terms**. Hence, the total cost of the investments below the threshold are not concerned by Article 50(1)(c) CPR. Physical investments above the threshold imply larger premises and most likely less problems to display durable plaques or billboards clearly visible to the public.

We confirm that **intangible assets** and working capital is exempted from the rules in Article 50(1)(c) CPR.

Audit and final recipients (4/4)

- **#35 Should the financial intermediaries also check public procurement procedures of public financial recipients in order to avoid irregularities with FI funding?**

No, it is not the task of the financial intermediary to verify the (public) procurement procedure at the level of final recipients. Any final recipient receiving support from the public resources should respect the applicable national legislation.

- **#36 Are auditors expected to verify the compliance with public procurement rules at the level of final recipients?**

No, audits are not conducted at the level of the final recipients, including compliance with public procurement rules.

Verifying eligibility of expenditure – intended purpose (1/3)

- **#37 What is the difference between "eligibility of the use for support for intended purpose (prospective)" and "eligibility of investments" (ex ante and ex post)?**

The verifications of the "eligibility of investments" are broader than just verifying the use for intended purpose, it includes for example verifications on eligibility of the final recipient, eligibility period, eligibility area, etc. All these verifications are performed ex-ante, at the moment when the support is granted.

- **#38 In the case of an equity fund how can the intended purpose be checked by a MA (if no HF)? e.g. in case of FI for innovation, digitisation, economic transformation and support to small and medium-sized businesses.**

The verification of the "is to be used for its intended purpose" is expected at the time the investment decision is taken and it is based on applications from final recipients, including business plans or equivalent.

Verifying eligibility of expenditure – intended purpose (2/3)

- **#39 How can one audit intentions? against what?/ Is a self-declaration by the final beneficiary sufficient?/ Should we use only certificates when we verify eligibility or we can use statements of final recipient?**

The verifications should be done on the basis of business plans or equivalent, as these are legal contractual obligations between the body implementing the FI and the final recipient.

Financial statements of final recipients may also be used (in many cases, banks or equity investors are using them as part of their normal business practice).

Depending on the type of verifications needed, self-declarations may be enough or not (e.g. for checking SME status a self-declaration won't be enough). Nevertheless, if the **normal business practice** of the bodies implementing FI consists in **relying on self-declarations**, the same would apply for FIs. Nevertheless, this should not prevent the auditors to check on a sample basis the veracity of those declarations, proportionate to the amount of public support, eventual risks identified and considering the available resources.

Verifying eligibility of expenditure – intended purpose (3/3)

- **#40 How is it verified that the financed investments have not been fully executed at the date of the investment decision as established in article 58.2 of the CPR?**

Article 58(2) CPR is to say that if certain elements of the investment were not completed or implemented because the final recipient did not have enough resources to complete it, the final recipient may ask for, e.g., a loan for the part of the investment which needs resources. Only the amount of the loan for the unfinished part of the investment for which investment decision was made will be eligible. The purpose of the provision is to prevent refinancing. The Union budget is not intended to pay for the part of the investment which the final recipient has already have carried out. An incentive effect is still present when the final recipient can raise finance that would not be available otherwise in terms of form, amount or timing.

The verifications can be conducted by reference to the information submitted by the final recipient during the application process, i.e. **self-declarations** by the applicant that the project is not completed, **business plan** (or equivalent) indicating the work to be undertaken or, where applicable, the findings of **appraisal processes** and/or **third-party reports** (such as a survey or energy audit or certificates issued by independent engineers).

Verifying eligibility of expenditure – intended purpose (3/3)

- **#40 [Ct'd]**

=> In the process of obtaining a loan, which includes all the steps from taking a loan application up to disbursement of funds (or declining the application), **the date of the investment decision precedes the actual signature** e.g., of the loan agreement and the disbursement of funds. For example, the machinery is paid in five instalments. Three instalments were paid by the final recipients own resources. Final recipient asks the bank for the loan from the ERDF programme FI to cover two remaining instalments, which the bank agrees to provide. The eligible expenditure in case of the FI according to Article 68(1)(a) CPR is the loan disbursed to the final recipient, i.e. in the example it is the loan disbursed to the final recipient to cover the two remaining instalments.

In certain cases, a reference to invoices can be made to demonstrate the end of the finished part and the start of the implementation of the elements that were not physically completed or fully implemented.

=> In case of equity, **the investment decision precedes the investment from the equity fund** to the company. In general, the due diligence could prove it or accounting records.

A partially complete investment can still be financed as long as the FI supports the elements of the investment that were not physically completed or fully implemented at the date of the investment decision.

Verifying eligibility of expenditure – other issues (1/2)

- **#41 How can a FI/auditor verify ex-ante that an investment will not be repaid by a grant?**

Grants must not be used to reimburse support received from FIs and FIs must not be used to pre-finance grants. This is to avoid that the Member States declare to the Commission an amount of eligible expenditure (e.g. loan and grant component) higher than supported investment.

- ✓ For **combination in one operation**, ex-ante, the verifications can be done based on the information provided by the final recipient in the application form (e.g. a self-declaration of final recipient) and the investment decision that the financial intermediary has taken to provide both forms of support. Ex-post, the verifications can be done based on separate accounting records that must be kept for each source of support by the financial intermediary.
- ✓ For **combination in two separate operations** the FI has to be audited as explained in the audit methodology, and the audit of grant operations has to follow the methodology for grants. The AA should pay particular attention to the risk of double declaration in its audits of operations and by taking into account the risk-based management verifications by the MA. The audit work should ensure that separate records are kept for each source of support in accordance with Article 58(6) CPR.

Verifying eligibility of expenditure – other issues (2/2)

- **#42 Reporting the achievement of outputs–it is to be done upon the final investment decision or should we wait until the completion of the project**

Reporting for the output indicators to which FIs contribute should be done on the same basis as the calculation of the eligible expenditure, i.e. loans/equity disbursed to final recipients.

Therefore, reporting of the achievements of outputs do not have to wait until the completion of the project.

- **#43 In grants, there is experience of what is a failure to meet objectives and establish causal reasoning in expenditures what about FIs?**

As explained above, such a link does not exist.

- **#44 As for the indicators. e.g. increase in value added, it can only be measured a few years after the completion of the project, as straight after the disbursement of the loan to the borrower the value added will not increase.**

The output indicators will be measured periodically, during interim reports on programme implementation.

Combination FIs (1/3)

- **#45 What will happen if the necessity to link the grant with the FI is not adequate?**

Managing authorities (MAs) designing operations that combine grants and FIs should undertake an analysis to show that the grant is necessary and directly linked to the FI at the level of the financial instrument and not at the level of each individual investment.

The grant may be justified to cover a financial gap, to achieve some policy objectives, to get incentives to get away from the grant mentality, etc.

As long as there is a logical justification of the need for grant in the FI, it is difficult to see how this link can be challenged externally.

If the justification is completely irrelevant, e.g. the grant has a completely different purpose than the FI and there is no link between the two purposes, than the grant component may not be eligible.

Combination FIs (2/3)

- **#46 The requirement "Grant < Investment" - is it applicable on a project level or on the level of the entire Funding agreement?/ As long as per instrument grant is lower than loan can we have higher than average rebates for some final beneficiaries? As long as average stays below 30%?**

The verification that the programme support in the form of grant < the value of the investments supported by the financial product is to be done at the level of the fund and not at the level of each investment; the verification is to be done in the final accounting year.

The level of and conditions for capital rebate to be provided to the final recipients will be agreed in the funding agreement, which, as the question implies, is expected to be modulated for each individual final recipient needs. It is possible that the capital rebate is higher or lower than the average, as long as it is in line with the funding agreement and the terms and conditions of the financing agreement with the final recipient setting out the criteria according to which the capital rebate will be activated. It is the task of the financial intermediary to monitor the level of the grant.

- **#47 Is the 49% grant requirement calculated at the level of single FI or at the level of fund/funding agreement (which may include several similar FIs)?**

As explained before, at the level of fund. The maximum possible level of grant is ≤50%.

Combination FIs (3/3)

- **#48 Can the body implementing FI outsource decision of granting technical support to another entity, e.g. a business incubator?**

The body implementing FI is responsible for the grant component as well. However, in cases where there is a lack of expertise on assessment necessary to award grant component, there could be a cooperation sought from competent body.

- **#49 Should the capital rebate cover both the private and public part of the loan or should it cover only the private funding ?**

It will normally be the public contribution of the loan that will be transformed into grant as a capital rebate. The breakdown between the loan and grants is updated after activation of the capital rebate and this level of monitoring will happen at the level of the public part of the loan. It is unlikely that the private investor will agree to forego the repayment of its loan by the final recipient.

Combination – capital rebate (1/2)

- **#50 A project is entitled to a 30% rebate. Should we impose how the final [recipient] uses it? Should it be used only to repay a part of the loan?**

In its business plan and loan application the final recipient will describe the planned use of the support based on which the financing decision is made, and the criteria for capital rebate triggers are decided. Hence, from the outset the purpose of the loan and the conditions for providing the capital rebate will be known.

For example, the financing to the final recipient will start as a 100% loan which should be used in its entirety for the purpose it is issued. The financial intermediary will verify if the carried-out investment has met the criteria to trigger the capital rebate. If the criteria are met, the capital rebate will be triggered, and only then the 30% of the loan to be repaid will be written off in the accounts of the FI and the repayment schedule of the final recipient will be revised for the remaining 70% of the loan to be repaid.

In practice, we should not trace the accounting of the final recipient proving the use of each euro of the rebate, the adjustments mentioned above in the legal contractual obligations are sufficient.

Combination – capital rebate (2/2)

- **#51 How to make compatible the principle that the FI can't be used to finance the grants and the capital rebate is only established ex post?**

As explained above, the only purpose of this legal provision is to ensure that the EU budget is not reimbursing as eligible expenditure a higher amount as the level of the investment (e.g. grant+loan = 100% of the investment cost).

For the loan combined with a capital rebate the financing to the final recipient starts in principle with a 100% loan. The loan is not pre-financing the grant, the grant becomes a percentage of the loan disbursed. The remaining amount of loan is repaid by the final recipient.

- **#52 Capital rebate is not double support but is changing form of the same support (same money)**

Yes, as above.

- **#53 We need real life examples of combination / capital rebate with Cohesion Policy Funds**

More information about combinations of FI and grants with capital rebate can be found here:

Implementation of grants and financial instruments combined in a single operation | fi-compass

Combination contd. (1/5)

- **#54 The capital rebate will be provided after project completion and this may happen after the end of the eligibility period so how will the audit be performed?**

The transformation of part of a loan into a grant (capital rebate) doesn't affect the eligible expenditure declared to the Commission. For example, a loan of 100 is declared to the Commission at the moment it is granted, independent of a subsequent activation of the capital rebate.

If the activation of the capital rebate happens before the end of the eligibility period, it affects only the transmission of data to the Commission according to Art 42 CPR.

If the activation of the capital rebate happens after the end of the eligibility period, it does not affect the relation with the Commission.

Combination contd. (2/5)

- **#55 In a guarantee financial instrument with interest rate subsidy in one operation when should we make the verifications? Within the year?**

It depends if the interest rate subsidy follows each instalment of the loan or if it is paid in one go at the beginning or the end of the period. The verifications should focus on the respect of the agreements in relation with the interest rate subsidy.

In all cases, the respect of the 50% limit of the grant compared to the level of guaranteed loans disbursed has to be verified at the end of the eligibility period.

Combination contd. (3/5)

- **#56 Regarding "In one agreement" concerning SF EQUITY FUND how will the grant be reflected in the Funding Agreement? As equity in the account of the SF EQUITY FUND?**

For combined support in a single FI operation, the grant component should be covered by the same funding agreement as the financial product itself. The funding agreement will reflect the purpose of the grant component, potential rates or amounts of grant that will be provided, how it will be provided to the final recipient, e.g. for their benefit or as a direct cash payment, how the amount of grant as compared to the financial product will be monitored, etc.

If the body implementing FI intends to use the implementation option according to Article 59(2)(a) as an investment of programme resources into the capital of a legal entity, then indeed the total amount of the programme resources will appear on the capital/equity side of the balance sheet of that legal entity. As the implementation starts the programme resources will be made as equity investments in final recipients and the grant component will be provided to the final recipient depending on its purpose.

Combination contd. (4/5)

- **#57 What does mean reimbursement of payment in case of SF EQUTY Fund and MA, without HF?**

We speak about the reimbursement by the Commission of the amounts included in the application for payments by the MA in the meaning of Article 92(2) and (3) CPR. Where the FI is an equity instrument set up in a single layer implementation option:

1) Following signature of the funding agreement and payment of the programme contributions to the FI the MA may submit the first application of payment of up to 30% of the programme contribution committed in the respective funding agreement, which the Commission will reimburse according to Article 93 CPR.
2) The subsequent payment applications from the MA to the Commission will be made based on the actual investments to final recipients made by the equity fund manager, also reimbursed according to Article 93 CPR.

The MA and the equity fund manager should have arrangements included in the funding agreement on how the FI is replenished with the necessary liquidity to carry out the subsequent investments.

Combination contd. (5/5)

- **#58 How double support will be checked if we don't require invoices?**

There are several safeguarding measures in case of combinations, for preventing double funding at the level of expenditure item, such as:

=> **Separate records** must be kept for each source of support (grant and FIs) in the case of both a combination in one operation (Article 58(5) CPR) and combination in two separate operations (Article 58(4) CPR) in accordance with Article 58(6) CPR.

=> The sum of **all forms of combined support** shall not exceed the total amount of expenditure item concerned (Article 58(7) CPR).

=> **Grants shall not be used to reimburse FIs** and **FIs shall not be used to pre-finance grants** (Article 58(7) CPR).

Under point (d) of part 1 of Annex X to the CPR, the **funding agreement** should include provisions for monitoring the implementation of investments. The body implementing the FI and grant support in a single FI operation would have a **monitoring system** in place that should ensure that the same expenditure is not declared twice.

MA and AA should be able **to verify and audit the functioning of the monitoring system** put in place by bodies implementing the FI to prevent double funding for combined support in one operation.

Methodology (1/2)

- **#59 Any recommendations for risk based management verifications for MAs who implement FIs for the first time (no historical data/experience)?**

MA/IB has to identify potential risk elements at operation / beneficiary level during the risk assessment; for example, the complex set-up and various actors and organisations involved in the implementation of FIs could trigger an increase in the risks. When MA considers a FI operation not risky (e.g. in case the implementation is done under the supervision of a body implementing a HF which has proven to have sound controls in place (e.g. a pillar assessed national bank), MA might decide to perform no (or only light) management verifications on the FI expenditure (e.g. verifying that the claim is supported by a list of loans showing that the final recipient and the expenditure is eligible).

On-the-spot verifications for FIs are performed on a sample (of FIs) proportionate to the risks and are carried out at the level of the Holding Fund (except for the EIB group/other IFIs), or Specific Fund in the absence of the Holding Fund. Checks at the level of the bodies implementing a Specific Fund with a Holding Fund set-up could be performed and adjusted in time depending on the risks identified (historical issues, results of audits, functioning of the Holding Fund and Specific Fund, combinations with grants).

It could be that the MA thanks to the arrangements put in place and based on the result of its first verification/or audit results consider that the operation is not risky and decides not to control any transactions. The check on the payment claim could be limited to reviewing the list of transactions without requesting any supporting documents.

Methodology (2/2)

- **#60 The audit focus aligns with the life cycle of an FI. What is the best timing and scope of an audit to happen as this cycle is long but findings could be important?/ isn't this audit taking place too late in the fund operation, making the audit miss its proactive goal to prevent irregularities and recoveries?**

It is recommended to perform system audits at the beginning of the programming period in order to prevent potential systemic deficiencies at a later stage.

- **#61 Is the verification of [final recipients] by the managing authority and the audit authority only based on a risk analysis?**

Under 2021-2027 programming period (Article 74(2) CPR), the management verifications shall be risk-based and proportionate to the risks identified ex ante and in writing. However, please note that no management verifications and no audits can be conducted at the level of final recipients (Article 81 CPR).

Sampling (1/3)

- **#62 Should the FI be audited as a separate stratum?**

There is no obligation to treat the FIs as a separate population. FIs can be included in a single audit population alongside the grant operations under the same programme. The decision lays with the AA and their professional judgement.

=> MAIN ADVANTAGE: Treating FI in a separate stratum becomes advantageous when errors are expected in the FI population which might potentially contaminate the rest of the population (errors will not be projected to the whole population, but just on the population of strata).

=> MAIN DISADVANTAGE: more strata, higher the amount of audit work.

- **#63 So, any error on FI will be extrapolated over the entire population?**

All the errors found in the FI selected in a sample have to be extrapolated to the whole population from which the FI has been selected.

=> If there is a separate stratum for the FI then it should be extrapolated within that stratum.

=> If no stratification is applied (FI and grants treated as one population), it has to be extrapolated to the whole population from which the sample was selected.

Sampling (2/3)

- **#64 Sampling stratification ultimately takes place at the level of the final recipients actually beeing supported via the intended purpose of the FI. What happens?**

The stratification (*if any*) takes place at the level of FI and not at the level of final recipient. When FI is considered as a separate stratum, it is up to the auditors to define then the sampling unit, i.e. investment, loan, guarantee, payment application. The audit verifications on the eligibility take into consideration the conditions at the time the investment decision was taken, based on the audit trail maintained at the level of beneficiaries (bodies implementing FIs).

- **#65 Does the same treatment of errors apply (no irregularities - HF can reuse ineligible transaction)? Does AA has to include such ineligible transaction into TPER?**

The re-use of a cancelled contribution is allowed by Article 103 CPR only in case of individual irregularities identified at the level of final recipients or bodies Implementing a specific fund. In case of systemic irregularities, the corrections are net.

Irregularities identified during the audit will impact the calculation of error rates (TER and RER).

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Sampling (3/3)

- **#66 Management costs are also part of the population, meaning they could be selected as 1 of the 30 audits of operations within one accounting year?**

Yes, if it is a separate sampling unit it can be selected.

- **#67 Was stratification of FI obliged in 2014-2020?**

No, it was not, but it was recommended. In 2014 – 2020 programming period, the audited population included only the advanced payments (tranches). An error rate without FI was calculated following an ECA recommendation.

- **#68 To select the transactions to be audited, should we abandon the random selection method provided for in the GDPR for AAs and rely only on the MAs verifications?**

The rules for sampling for the purposes of audit of operations in the 2021-2027 period can be found in the Sampling Regulation. The same rules apply for FI as for grants, without distinction.

When defining the audit parameters (i.e. expected error rates), AAs might decide, based on their professional judgement to take reliance from the MA's control system (this will imply for example a smaller sample).

Irregularities (1/4)

- **#69 Will the overbooking be possible to replace irregular expenditure in a FI?/ [Is it] possible to set up the list of additional eligible investment to be used to replace irregularities identified in final year if overbooking isn't possible?**

A buffer can be used to replace possible ineligible expenditure identified in the expenditure clearing the advance (e.g. in the last accounting year). Ineligible expenditure declared in payment applications impact the error rates (similar like for grants).

- **#70 In case of FI combined with grants for the same expenditure under Art. 58.4, does any irregularity of the grant also lead to the cancellation of (part of) the loan?**

When there is an irregularity at the level of the grant (e.g. irregular technical support), but the loan is regular and eligible, the Commission can reimburse only the loan, but not the grant component. The grant and the loan components may have to be recovered from the final recipient as it was agreed in the funding agreement. Bodies implementing FI shall **not** be asked by MA to payback any grant beyond the normally recovered amounts (i.e., when recovering a loan).

Irregularities (2/4)

- **#71 How many irregular or eligible support from previous FI have been verified as non eligible and recovered from audits? How effective are audits of FIs? Lessons?**

Findings in FIs represented only 0,5% from total reported findings in 2014-2020.

We consider that FI operations are less risky than grants for the EU budget due to their repayable nature and the involvement of private actors acting based on professional standards subject to constant supervision.

The low level of irregularities in FIs under 2014-2020 programming period might be due to the use of tranches, the possibility to replace ineligible expenditure with regular one (the use of buffer) and the fact that the confirmation on legality and regularity is expected only at closure.

Irregularities (3/4)

- **#72 In case of irregularity at the level of final recipient and the corresponding amount is unrecoverable, what should be done?**

Financial corrections have to be applied for any irregular amounts identified, in line with Article 103 CPR. In 2021-2027 programming period, the recoveries fall entirely under the responsibility of the MS. Independent on whether an irregularity is recoverable or not, corrections should be implemented either as withdrawals from payment applications or as deductions from accounts. Nevertheless, these are not net corrections, and the irregular amounts can be replaced with other regular expenditure according to Article 103(5) CPR or within the programme, with other operations.

- **#73 What is the risk-based approach used in preventing irregularities and how capable are MAs to apply this approach to monitoring or audit?**

The objective of the risk-based approach consists in selecting those transactions which are, according to certain criteria, the riskiest one – the one where there are high risks that irregular expenditure could appear. Those criteria might be based on MA's previous experiences, if any.

Irregularities (4/4)

- **#74 In case of Irregularity/ineligible expenses how are the legal costs for collection of the ineligible part of the loan/grant from the final recipient expected to covered? Is it ok to cover them with returned public funds from other loans or should they be covered at the expense of the Management fee of the Holding fund/Financial intermediary?**

Eventual costs for recovery of ineligible part of the loan/grant from the final recipients cannot be covered by resources paid back as they do not qualify under the conditions in Article 62 CPR. Such costs should be envisaged in the MCF structure paid from the programme contributions.

Audit and payment claims (1/2)

- **#75 The first payment application: advance of max 30% programme contribution. Does this mean 30 % of the European funds not 30% percent of European fund + national funds?**

According to Art 92(2)(a) CPR, 30 % of the total amount of programme contributions committed to the FI under relevant funding agreement, so EU + national and private, if any, co-financing to a financial instrument (Article 2(19) CPR).

- **#76 Should the AA audit the clearance of the advance payment as a "normal" payment claim?**

As the expenditure clearing the advance is not declared in a payment claim, eventual errors cannot be included in the calculation of error rates by the AA.

Assurance on the legality and regularity of this type of expenditure not included in payment applications may be obtained by the AAs through **specific audit tests** during audits to be conducted during the accounting year when the clearance of the advance takes place (NB. this could also take place in the last accounting year). The AAs are expected to report on the outcome of these checks in the annual control reports.

Audit and payment claims (2/2)

- **#77 How can we organize the verifications over the beneficiary payments from MA to be included in the information send to COM ?/ So eligible expenditure audited only means eligibility based on business plans or equivalent documents (since receipts are not required)?**

(1) MA is expected to perform risk-based management verifications over the payment claims from beneficiaries (bodies implementing FIs) cf. Article 81(1) CPR. An appropriate audit trail must be maintained.

(2) The audit work on the eligibility of expenditure include:

- General eligibility rules like compliance with the eligibility requirements set out at national level or in programmes, i.e. verification of eligibility of final recipients, such as SME status and State aid aspects, eligibility conditions laid down in the Funding Agreements and investment decisions (e.g. eligibility area, eligibility of expenditure, eligibility period).
- Specific eligibility rules for FIs, like compliance with the rules in Article 68 CPR, i.e. checks of the amount paid (or set aside for guarantees) and MCF, the verification of the use of interest and other gains, checks of eligibility rules in case of implementation of FI across consecutive programming periods. By the end of the closure of programming period, that eligible expenditure declared to the Commission should not exceed the total amount of support paid.

Other questions (1/7)

- **#78 How to check potential double funding FIs in the previous period?**

MA/IBs and the body implementing the FI should have adequate **control and monitoring systems** in place to ensure the same expenditure item is not declared twice, for instance through **data mining and risk-scoring tools**, **self-declarations** from final recipients or **demarcation lines** between funds. The funding agreements should include such provisions.

The Commission also takes steps to assess the reliability and robustness of the national control systems and includes **targeted checks on double funding** (i.e. databases used to avoid double funding) as part of its ex-post and system audits. It may also perform additional audits in case of suspicion of serious irregularities.

The Commission auditors systematically audit the measures put in place by MA/IBs to ensure the avoidance of double-funding on the sample selected for the audit.

When applying for support, the future final recipient/grantee may be required to **communicate its previous support** so that the grant agreement/investment agreement to be drawn up includes appropriate provisions that help reduce the risk of double funding.

Other questions (2/7)

- **#79 How can you ensure that there is no double support for equity operations?**

The purpose of the equity investments is to give to the final recipient (e.g. start-up) the financing means to realise their business plan. The use of the equity support does not have to be broken down by types of investments. The equity fund manager invests in the final recipient based on a due diligence and the funds will be used for the development of the final recipient.

If the final recipients receives other sources of EU financing, they will have to respect the rules of those funds.

- **#80 Is real increase in job should be achieved and checked, or can it be done "used for intended purposes" principle?**

How the indicators are reported, monitored and checked depends whether they are output or result indicators. Reporting for the output indicators to which FIs contribute should be done on the same basis as the calculation of the eligible expenditure, i.e. loans/equity disbursed to final recipients. For result indicators (outcomes), please find the Staff Working Document on the performance monitoring and evaluation of the ERDF, CF and JTF.

Other questions (3/7)

- **#81 Will private co-financing at the level of the final recipient be eligible as a national contribution?**

Private co-financing provided to the final recipient by a third party at the point of the investment can be counted as national private contribution if the programme or individual priorities are set on the total contribution according to Article 112(2)(a) CPR. It is the task of the body implementing FI to keep documentary evidence demonstrating the eligibility of the underlying expenditure covered by the private co-financing at the level of the final recipient according to Article 59(8) CPR.

- **#82 Can the eligible requirement of art 58 (2) of the CPR for FI investments "which do not find sufficient funding from market sources" be complied with on ex ante level?**

Absence of the sufficient market sources should be considered at the level of the FI and not at the individual investments.

Other questions (4/7)

- **#83 How will auditors address the implementation of the DNSH criterion in FIs?**

The auditors will check (system audits and audit of operations) the compliance with DNSH only if such criteria are specifically indicated in the programme and/or Funding Agreement.

The auditors' task will not be to challenge or re-perform the DNSH assessment.

If DNSH specific criteria, conditions or specific mitigation measures are indicated in the programme or it's DNSH assessment, the auditors have to verify how they are followed further in the implementation of the FI operation (e.g. how these criteria/conditions were transferred to the funding agreement with the bodies implementing financial instruments and/or final recipients (if applicable only) or how managing authorities ensured it in other ways, if any).

Other questions (5/7)

- **#84 State aids-pari passu: how the AA will do their verification about the starting position of the public bodies and the private operators)?(2016/C262/01-point 87.d)**

The assessment of the pari-passu conditions is done on the basis of the 4 criteria of point 87. Point d) refers to the fact that different investors should have the same starting point information about the undertaking in which they invest so that no investor has an advantage. The associated audit risk if quite low regarding this specific point as the pari-passu conditions are ensured either by the nature/structure of the FI (loans or guarantees) or by the equity fund manager who has to align interest between the investors and has its own skin in the game. This is part of the due diligence process.

Other questions (6/7)

- **#85 is the Arachne tool for fraud detection suggested to be used?**

Arachne will become a compulsory IT tool once the upcoming modifications in the Financial Regulation come into force. It is highly recommended to MA/AA to use it.

Please note however that in the case of financial instruments, the fraud risk is completely different compared to the fraud risk for grants given the repayable nature of the support. So, the use of Arachne (i.e. by MA) should be proportionate to the risk identified (as a result of their risk analysis).

- **#86 Is the deadline for system audits of 21 months from approving the programme for MAs implementing FIs for the first time (from KnowHub) a recommendation or obligatory?**

Article 78 CPR requires AAs to conduct system audits of newly identified managing authorities and authorities in charge of the accounting function within 21 months of the decision approving the programme or the amendment of the programme identifying such an authority. If a MA is not a newly appointed MA, but it is the first time it implements FIs, this is not subject to this Article 78 CPR.

Other questions (7/7)

- **#87 The new financial regulation will include requirement of the Early Detection and Exclusion System (EDES) also in case of final recipients - seems problematic.**

The extension of EDES to shared management was agreed to that Member States (i.e. MA/AA) to check the EDES database at the moment of the award and on the first level (only direct applicant/ participants/ beneficiaries but not subcontractors); voluntary checks remain possible at any time. CPR programme authorities should ensure that payment application concerning an excluded person are not submitted to the Commission (see Article 139(2) sub-para. 3 FR).

The provisions will only apply as from 2028.

- **#88 Can the cpr 2021-2027 with respect to FI be applied to the FI declared in 2014-2020 and closure.**

NO, each programming period follows its own rules.

Thank you!

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