



fi-compass Knowledge Hub

Audit and control of financial instruments

2014-2020

Notes of workshop

The Knowledge Hub has been developed to meet the growing need amongst experienced practitioners for events and materials that provide a more in-depth look into topics affecting financial instruments. Its format utilises email exchanges to promote a longer term engagement between participants together with traditional face to face and online workshops to allow experienced practitioners to work together to explore the subject matter through peer to peer exchange and expert-led sessions.

In order to encourage openness between the parties, the discussions are undertaken under the Chatham House Rule which states: “When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.”

In particular, the representatives of the European Commission, namely the Directorate-General for Regional and Urban Policy (DG REGIO), have participated in the Knowledge Hub to receive feedback from the Member States concerning the audit and control of financial instruments in the 2014-2020 programming period. The participation of the representatives of DG REGIO and the European Investment Bank should not be interpreted as an official endorsement of any of the suggestions that may be discussed and/or described during the Knowledge Hub.

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1. Introduction

The fi-compass ‘Knowledge Hub – Audit and control of financial instruments 2014-2020’ took place between April and July 2021. Expert practitioners came together with specialists from the European Commission, DG REGIO and fi-compass to consider a number of topics related to the audit and control of shared management financial instruments in the 2014-2020 programming period.

The discussions considered the audit and control¹ framework for shared management financial instruments. The methodology for audit and control should take into account the specific risks linked to the implementation of the financial instruments, which are different from those of grants. The measures should also reflect the different types of financial products (loans, guarantees, equity, quasi-equity), the different implementation options, and the different phases of implementation (set-up phase, implementation phase and closure when eligibility is confirmed).

Risk areas include:

- Verification of the small and medium-sized enterprise (SME) status,
- Eligibility of final recipients and underlying investments, and
- Use of the support for the intended purpose.

These three risk areas were the core topics discussed within this Knowledge Hub.

Other typical risk areas are eligibility of expenditure, eligibility of management costs and fees, selection of the fund of funds (FoF), compliance with State aid rules, compliance with disbursement thresholds (Art. 41 CPR²) and the use of the reflows.

Audit authorities, managing authorities and the bodies implementing financial instruments should establish audit and control measures proportionate to the risks identified in order to ensure the legality and the regularity of the operations.

Knowledge Hub participants were drawn from audit authorities, managing authorities, FoF managers, the European Investment Fund (EIF), DG REGIO’s financial instruments and audit units and the fi-compass team. Two online workshop sessions were held to discuss a number of questions related to audit and control of the above risk areas for financial instruments.

This note captures the experiences shared between the participants and highlights topics of interest that may be of use to practitioners implementing financial instruments in the future. The note is not a guidance in relation to the audit and control of financial instruments in the 2014-2020 period. This account of the discussions does not constitute official endorsement of the points set out in this note.

¹ The notion ‘control’ covers management verifications and controls performed by bodies implementing financial instruments.

² Common Provisions Regulation: Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006. <https://eur-lex.europa.eu/eli/reg/2013/1303/2020-12-29> (05.08.2021).



2. Key notes

Verification and control activities of risk areas start from early on and are tailored to the specificities of financial instruments.

- **Financial intermediaries (i.e. the entities deploying the support to final recipients) are responsible for verification and control activities.** Risk areas related to financial instruments are for instance if final recipients meet the SME definition, if all other potential eligibility criteria set for the concerned financial instrument are met and if the support was used by the final recipient for the intended purpose.
- It is **good practice for managing authorities and FoF managers to support financial intermediaries**, for instance by providing template documentation and offering capacity building to enable them to familiarise themselves with the requirements of the EU Regulations relevant to financial instruments.
- **Well established controls from early on** can prevent systemic irregularities later on. If needed, new preventive or corrective measures should be introduced without delay.
- **Audit and control activities** should be **undertaken throughout the implementation**. Audits help to identify issues, allowing corrective actions to be taken, thus contributing to a successful implementation of the financial instrument in line with the legislative framework.
- **FoF's early monitoring visits** to the financial intermediaries are a useful measure for the prevention of irregularities and inconsistencies.
- The audit and control activities should take into consideration **the nature and specificities of financial instruments**, and the differences to grant schemes.

There is a focus on establishing 'reasonable assurance' through the checks.

- Bodies undertaking audit activities should **establish 'reasonable assurance'** that the criteria that need to be checked for a final recipient are met. Respective control work needs to be performed but bodies involved should **avoid 'gold-plating'**.
- Regarding the viability of final recipients' projects/investments for example, **managing authorities can reasonably rely on the assessment of financial intermediaries** during the investment appraisal process which is performed in line with the **standard banking or investment practice**. There is an alignment of interest established between financial intermediaries and managing authorities through the financial intermediaries' 'skin in the game' in the financial instruments and they are incentivised to undertake such appraisal processes rigorously. Managing authorities can expect to rely on these processes in relation to this aspect of eligibility. FoF managers should ensure (e.g. during the selection process of the financial intermediaries) that the adequate procedures for this purpose are in place and are implemented properly by the financial intermediaries.

There are tools for checking the SME status.

- There are **different resources and tools** available to support the bodies performing the controls and audits. Self-declarations by the SME are not sufficient on their own but are a good starting point. Other resources include for instance national commercial registers or certification by a national authority. Tools such as ARACHNE³ (available to EC and Member States only) or other commercial ones might also be used in the process of the SME status verification. The role of the body performing the controls is to examine the documentation available and not to 'investigate'.

³ <https://ec.europa.eu/social/main.jsp?catId=325&intPageId=3587> (05.08.2021).



- A potential rerun of verification activities by financial intermediaries might be needed only in case of extraordinary new corporate developments. For instance, usually the relevant date for assessing the SME status is the date of the credit committee approval (or equivalent) of the proposed loan or equity investment. It is typically followed by a period of weeks for negotiation and signing the financing agreement between financial intermediary and final recipient. There should be no need to reassess the status of the final recipient unless there has been a significant passage of time, in excess of the normal time required to finalise such agreements.

The ‘Audit methodology’, tailored to the special features of financial instruments, has been updated in 2021 to reflect legislative changes in the crisis context and provide more clarification on closure.

- The **‘Audit methodology for auditing financial instruments in the period 2014-2020’⁴** is a helpful document not only for all audit authorities for their audit activities but also all for other bodies involved in financial instruments such as managing authorities and FoF managers, for their management verifications and control activities.
- It is **tailored to the particularities of financial instruments**. When auditing financial instruments it is important to bear in mind that there are differences in how shared management financial instruments work in comparison to grant schemes.
- The 2021 update of the audit methodology includes a number of **novelties related to the recent legislative changes in the COVID-19 pandemic crisis context as well as control activities for financial instruments at closure**.
- With the 2021 update, a newly introduced annex describes comprehensively the **management and control responsibilities** of the different stakeholders involved in financial instruments.

⁴ The 2021 update of the audit methodology is available on the fi-compass website: <https://www.fi-compass.eu/publication/other-resources/audit-methodology-FIs-2014-2020-update2021> (05.08.2021).



3. Audit methodology for auditing financial instruments in the period 2014-2020

3.1 Overview

The key features and updates of the ‘Audit methodology for auditing financial instruments in the period 2014-2020’⁵, were explained by DG REGIO auditors during the Knowledge Hub.

The methodology was developed for the first time in 2019⁶. The document is primarily aimed at Commission auditors and audit authorities in Member States. It can be also a useful reference for managing authorities and FoF managers for their management verifications and controls. The document describes the type of work to be carried out by auditors for financial instruments, the specificities of those instruments implemented by international financial institutions (IFIs), including the European Investment Bank Group (EIBG), and the treatment of irregularities.

3.2 Key 2021 updates

The 2021 updates of the audit methodology address “*inter alia*” the recent legislative changes and provide more clarifications on treatment of errors related to financial instruments at closure. The current update especially takes into consideration the new flexibilities for financial instruments introduced by the Coronavirus Response Investment Initiative (CRII), the Coronavirus Response Investment Initiative Plus (CRII+) and the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) packages of measures.

The key 2021 updates of the audit methodology refer to:

- The audit population for verifying compliance with the payment of tranches (art. 41 CPR) – to give maximum flexibility for drawing the sample,
- The use of support for intended purpose – managing authorities to have procedures in place, extent of controls depend on investment progress,
- Updates to align with the CRII+ package,
- Clarification on the verification of the viability of investments,
- Treatment of errors at closure – no overbooking; replacement of irregularities.

The methodology includes also the following template documents as annexes:

- An audit checklist (Annex 1),
- A sampling manual to the audit authorities (Annex 2),
- Guidance on the verification of the use for intended purpose in case of working capital (Annex 3), and
- An overview of the management and control responsibilities (Annex 4).

⁵ The 2021 update of the audit methodology is available on the fi-compass website: <https://www.fi-compass.eu/publication/other-resources/audit-methodology-FIs-2014-2020-update2021> (05.08.2021).

⁶ The version of the audit methodology before the 2021 update is available on the fi-compass website: <https://www.fi-compass.eu/publication/other-resources/audit-methodology-auditing-financial-instruments-period-2014-2020> (05.08.2021).



The last annex dedicated to the management and control responsibilities of different actors is a new document, introduced for the first time in the 2021 update of the audit methodology. This ‘who does what’ document is intended to help understand the legal responsibilities and eventually avoid ‘over control’ and gold-plating when performing controls concerning financial instruments.

The audit methodology addresses also specificities for the audit of financial instruments implemented by the EIBG and other IFIs.

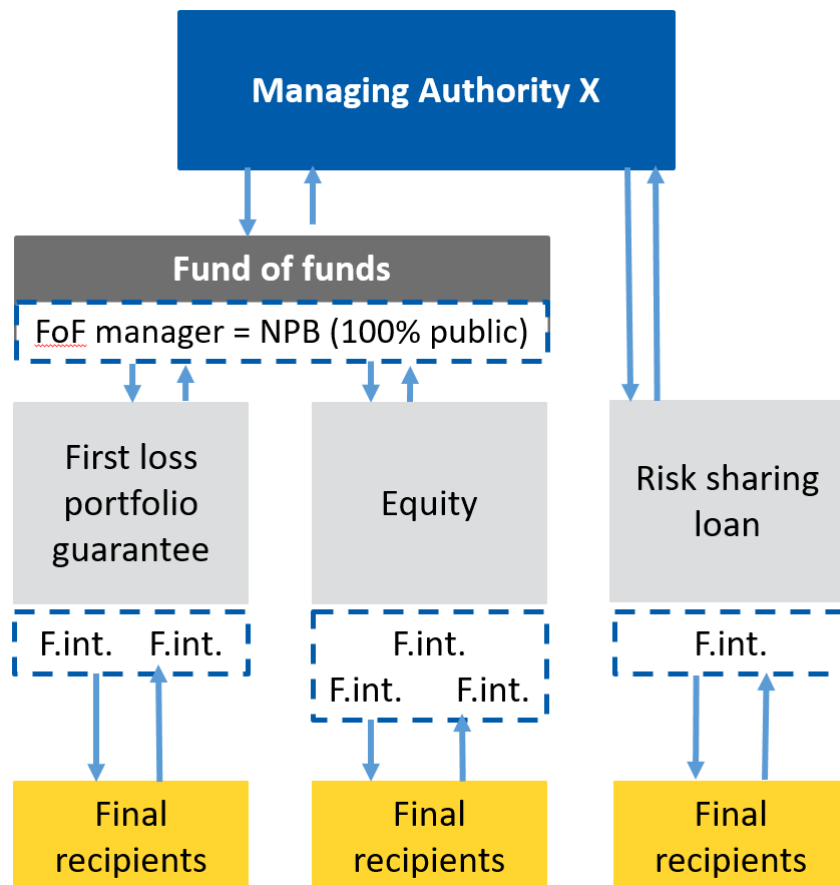


4. Audit and control in practice

4.1 Case study – Financial instruments for innovative SMEs

The Knowledge Hub considered several topics relating to the audit and control of financial instruments based on a hypothetical case study. The case study was based on an operation comprising three financial instruments: a first loss portfolio guarantee (FLPG) and an equity fund, both implemented through a FoF (a National Promotional Bank – NPB), and a loan financial instrument implemented by a financial intermediary directly appointed by the managing authority. The structure of the case study is shown in Figure 1 below.

Figure 1: Implementation structure of the financial instruments in the case study



4.2 SME status checks

According to Article 2 of Commission Recommendation 2003/361⁷, an SME is a company with a staff headcount less than 250 and not exceeding either the turnover of EUR 50m or the balance sheet total of EUR 43m. Although the different financial instruments target different types of SMEs, the need to verify if the SME definition is met by final recipients is shared across all the instruments.

⁷ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises <http://data.europa.eu/eli/reco/2003/361/oj> (05.08.2021).



Knowledge Hub participants exchanged their experience in verifying the SME status of final recipients. Several ‘who does what’ topics related to the management and control responsibilities were discussed with this regard: what are the responsibilities of the different stakeholders (financial intermediaries, managing authority, FoF manager) and when and how the checks should be done. The participants exchanged also on a number of additional practical topics related to the SME status verification, based on their experiences.

WHO: Financial intermediaries have the frontline responsibility for the SME status checks while managing authorities and fund of funds managers offer support

The frontline responsibility for checking that the final recipient is an SME lies with the financial intermediaries. The overall responsibility for the programme implementation lies with the managing authority.

It is good practice for managing authorities and FoF managers to take a proactive approach to support financial intermediaries with the assessment of the SME status. Template documentation setting out the relevant criteria to be used in assessing SME status is often provided by the managing authorities to financial intermediaries. This can be complemented by capacity building training sessions to enable financial intermediaries, often from the commercial banking sector, to familiarise themselves with the requirements of the relevant EU regulations. By taking these steps during the set-up of the financial instruments, managing authorities ensure the financial intermediaries understand their responsibility well and are equipped to perform their responsibility to verify the SME status of their final recipients.

It is important for managing authorities to perform an oversight of verification of SME status. This should be done in addition to any checks undertaken by a FoF manager, who will also be undertaking verification activities usually on a sample basis during monitoring activities as set forth in the funding agreements. The Knowledge Hub participants shared experience of how the roles of different parties involved in the implementation of financial instruments can be coordinated to ensure that reasonable levels of assurance are in place with the participation of all bodies concerned.

WHAT: Scope of the checks

Financial intermediaries are responsible for checking the SME status but are not required to undertake exhaustive investigations for each final recipient. There is an expectation of ‘reasonable assurance’ that should be applied to the processes to verify the SME status and other aspects of the final recipient’s eligibility. The type of information they should use to verify this includes self-declarations by the SME (the European Court of Auditors (ECA) has clarified though that a self-declaration is not sufficient on its own), copies of accounts and information in the public domain such as national registers of companies. Specialist services may also be used in line with the prevailing banking practice in the country.



HOW: Additional available tools for checking the SME status

In addition, external tools might be used to support the SME status verification.

ARACHNE is [an integrated IT tool](#) for data mining and data enrichment developed by the European Commission to support managing authorities in their administrative controls and management checks in the area of shared management funds. Licenses, free of charge for the Member States, can be enquired from the European Commission.

The Knowledge Hub participants mentioned also a number of external data sources by commercial providers that can be potentially used for the checks. Orbis is an external data source with detailed financial information on companies and entities worldwide, by the commercial provider Bureau van Dijk, a Moody’s Analytics company. This tool is used by some fund of fund managers and financial intermediaries in their process of SME status verifications. Pitchbook is a private provider of data covering private capital markets, including venture capital, private equity and M&A transactions.

Some managing authorities use data from national State aid registers as ‘proxy tools’ to support their SME status verification. In practical terms, these managing authorities use electronic tools to put all final recipients to an initial check based on an algorithm that applies several business rules based on the SME status criteria. Subsequently, a risk-based sample of projects will be subject to a more detailed check as part of the on-going monitoring activities. This more in-depth review involves site visits to financial intermediaries (done remotely during the COVID-19 pandemic) and review of documentation including the loan documents, the financial intermediary’s credit risk assessment and supporting documents such as business plans and financial statements.

WHEN: The reference date for the check is the date of the investment decision

The relevant date for assessing the status of an SME is the date of the credit committee approval (or equivalent) of the proposed loan or equity investment. It is typically followed by a period of weeks for negotiation and signing the financing agreement between financial intermediaries and final recipients. There should be no need to reassess the status of the final recipient unless there has been a significant passage of time, in excess of the normal time required to finalise such agreements.

The potential for time to pass between an investment decision and signature was, however, highlighted in relation to a project that did not sign the financing agreement until nine months after the credit approval. In such a case there is the potential for changes in the status of the final recipient: the company might have for instance purchased another company. This means that a rerun of verification checks may be justified, although it will depend on the circumstances. Ultimately, financial intermediaries must assess the risk depending on the particular circumstances.

Additional topics discussed related to the SME status checks

A number of additional topics related to the SME status checks was discussed during the Knowledge Hub:

- There might be situations **where existing tools discussed in the session do not provide relevant information**. New companies in smaller countries and sector-specific final recipients such as property development funds may not be featured in the databases used to verify SME status. In such



cases, it is necessary for the financial intermediaries and other verifying bodies to request more information from the applicant final recipient.

- **Headcount can be a challenge to verify.** This regards for instance calculating the headcount of companies which work with a large number of self-employed contractors such as food delivery, ridesharing and package delivery platforms. The status of owner-managers in the headcount was also discussed. Ultimately, a ‘common sense’ approach is needed to verifying headcount based on local accounting practice for example in relation to reporting Full Time Equivalent (FTE) staff in annual returns or relying on Annual Work Unit (AWU) calculations which may have been already produced by accountants or auditors of the final recipients.
- The **challenges of checking and assessing potentially linked companies** was also discussed. The methodology has a guide to the tools to be used. Nevertheless, there are still challenges, for example where a sister company in another jurisdiction is declared as not being active. It is difficult for a financial intermediary to verify this where they do not have access to appropriate tools in the other jurisdiction. The need to avoid gold-plating was also discussed.

4.3 Eligibility of final recipients

There are potentially several further eligibility requirements related to final recipients, in addition to the SME status of final recipients, depending on the financial instrument. Eligibility requirements are derived from the CPR, for instance Article 6, stating that operations should comply with applicable Union law and the national law relating to its application ('applicable law'), or Article 37(1), which provides that financial instruments shall be implemented to support investments which are expected to be financially viable. The Investment Strategies of the concerned financial instruments define the eligibility criteria for the final recipients to qualify for financing through the respective financial instrument. The criteria included in the Investment Strategies need to be in line with the underlying programmes. These criteria are also mirrored in the funding/guarantee agreements with the selected financial intermediaries.

The ‘who does what’ topics related to the management and control responsibilities for checks of the eligibility of final recipients were discussed during the Knowledge Hub: what are the responsibilities of the different stakeholders (financial intermediaries, managing authority, FoF manager) and when and how the checks are to be done.

WHO: The primary responsibility for eligibility checks lies with financial intermediaries

The primary responsibility for performing checks of the final recipients’ eligibility in line with the set criteria lies with the financial intermediaries. Usually, this is documented in the financial intermediary’s loan/investment assessment. The managing authority and, if applicable, the FoF manager, should perform their monitoring and verification checks on a sample basis from the list of investments. Participants from managing authorities and FoF managers shared during the Knowledge Hub how they structured their control activities. These can be at times very complex if the body is in charge of a number of financial instruments. Participants exchanged during the Knowledge Hub also on their sampling approach. Well established controls from the FoF or/and the managing authority early on can prevent systemic irregularities later.

WHAT: Information to verify eligibility

The information to be used by financial intermediaries to assess the wider eligibility of final recipients includes the SME status, the NUTS⁸ classification of the operation, the NACE⁹ economic divisions, the date of final

⁸ Nomenclature of territorial units for statistics: <https://ec.europa.eu/eurostat/web/nuts/background> (05.08.2021).

⁹ Statistical classification of economic activities in the European Community:

<https://ec.europa.eu/eurostat/documents/3859598/5902521/KS-RA-07-015-EN.PDF> (05.08.2021).



recipients' registration, the declaration confirming no prohibited activities, the final recipients' business plans in case of investments and any self-declarations collected during loan application stage. However, the nature and extent of each of these items will vary depending on the type of the financial instrument. For example, a seed loan instrument targeting start-ups would not necessarily require a detailed business plan, reflecting the nature of its target final recipients. Similarly, equity investments entitle fund managers to access the full range of company information held within the company making the verification straightforward.

HOW: The importance of 'standard banking practice'

The importance of 'standard banking practice' to the implementation of financial instruments through financial intermediaries was discussed in relation to the audit and control of the instruments. Ensuring a minimum co-investment or other risk sharing rate ('skin in the game') aligns the interest of the financial intermediary with the managing authority in relation to verifying several elements relating to the eligibility of a proposed investment. The managing authorities' principal responsibility is to ensure that the financial intermediaries' processes are appropriate, initially through the selection procedure and thereafter through monitoring procedures. In addition, and as part of its supervisory function, the FoF and the managing authority will review on a risk-based sample basis how financial intermediaries ensure compliance with programme conditions. Audit and control procedures should as much as possible respect standard banking practice and do not question 'expert decisions' taken by financial intermediaries (e.g. assessments whether a project is viable).

The check of the viability of final recipients' projects/investments is an example of where managing authorities can reasonably rely on the judgement of financial intermediaries during the investment appraisal process. In common with the usual banking or investment practice, financial intermediaries have expertise in evaluating the final recipients' applications. The evaluation of the risk of a proposed investment is usually part of the approval and pricing processes within financial institutions / fund managers. Financial intermediaries with 'skin in the game' are incentivised to undertake such processes rigorously and as such FoF managers and managing authorities are entitled to rely on these processes in relation to this aspect of eligibility.

WHEN: Date of commencement of project

Projects may be commenced before the financing agreement is signed. This reflects common practice in many places where final recipients are keen to start work before the legal documentation has been finalised. The requirement is that the project must not be completed at the time of the investment decision (i.e. credit committee approval). In many places the practice is that goods and materials may be ordered and delivered in advance of the signing of the financing agreement but typically invoices are not paid in full until after the documents are in place (or only an advance is paid with the final recipients' own resources).



Audit and control activities should be undertaken throughout the implementation, fostering a partnership approach between auditors, managing authorities and implementing partners.

For instance, it is advisable to start on-the-spot checks early in the process so that in case of findings, new measures can be introduced without unnecessary delay. Under a FoF structure, the FoF manager will be responsible for monitoring and reporting to the managing authority on the performance of the financial intermediary. Nevertheless, the managing authority has a responsibility to undertake their own verification activities based on the information supplied by the FoF manager and its own direct engagement with financial intermediaries. Audits carried out by the audit authority can help identify these issues during the implementation, allowing corrective action to be taken in a timely way, ensuring a successful implementation of the financial instrument.

4.4 Use of support for the intended purpose

The intended purpose of support that a final recipient receives is typically detailed in the loan agreement or business plan or credit risk assessment. This will be in line with the general requirements set out in the Investment Strategy and mirrored in the funding/guarantee agreements. Participants reported how this is often an area of focus for external audit activities.

Investment financing based on invoices

For some financial intermediaries, it may be standard banking practice to request invoices as evidence of expenditure prior to disbursement of tranches of loan finance. This is in general a straightforward activity for investment loan products and familiar to some financial intermediaries. The audit and control of such expenditure is also facilitated through sampling of projects and use of the invoices. Also it is common practice that for loans disbursed near closure, the business plans or the supported investments might be realised/concluded after the end of the eligibility period.

On the other hand, loan support for working capital might not by its nature be verified by reference to invoices. The verification of the need for working capital support will then be done by reference, for example, to the final recipient company's business plan which should identify the financing requirements or final recipients' internal accounts with an indication of the expenses paid with the working capital support. It would not be standard banking practice to request invoices to support working capital type expenditure and more general monitoring activities would be expected to be in place based on the financing agreement with the final recipient.



Intended purpose of equity investments – do you need to count pizza?

The nature of expenditure in relation to recipients of equity investment is potentially even more diverse and should not be verified by reference to invoices. Participants discussed the hypothetical situation where a start-up buys pizza for their weekly team meetings. Should future audit and control activities review the invoices for the pizza and is it eligible expenditure? In such cases, the purpose of the financial instrument's investment is to **provide the enterprise with capital to grow its business**. All activities of the company related to its development, including ordering pizza for team meetings, can be legitimate and audit and control activities do not need to extend to these sort of questions. In general terms, in any event, audit activities should not extend to final recipients and for equity investments, the fund manager should be the subject of verification activities based on its regular reports it receives from the enterprise. In other words, auditors don't need to count the pizza!

The Knowledge Hub participants also discussed that, for instance in case of a loan to a final recipient, the managing authority does not physically check if an investment is completed after the project was finished and the invoices (or other proof of use of funds) submitted. The check of the submitted reports are sufficient in terms of the control activities in this case.



5. Final comments – a ‘financial instrument specific’ approach to audit and control

The event highlighted several experiences of practitioners which illustrated the growing recognition that financial instruments require a tailored approach to audit and control, different from how the activities are done for grants.

Great progress has already been made and the 2021 update of the audit methodology is a further step forward. Several features specific to financial instruments were highlighted during the Knowledge Hub. The option to replace irregularities during closure of the programme, as long as the irregularities are not systemic, was discussed. Under this arrangement, an ineligible investment can be swapped out of the declared investments at closure and replaced with other investments which comply with the applicable eligibility criteria. This is a key flexibility available to financial instruments that does not exist for grants. The clarification in the updated methodology in relation to the CRII+ flexibilities is also welcome, for example formulating that no evidence is required to verify working capital expenditure.

There remains a risk of ‘gold-plating’ of audit requirements, notwithstanding the emphasis on ‘reasonable assurance’. For example, the extent of verification work to be undertaken by financial intermediaries is sometimes interpreted as requiring a full investigation rather than a reasonable level of checking. Similarly, the absence of requirements from grants (for example in relation to information required in applications for support) can, on occasion, be used to challenge financial instrument processes. The use of information external to the financial intermediaries application process can also in some cases result in queries being raised that do not directly relate to the specific investment and thus can be difficult to rebut without recourse to final recipients.

The clarification that in some cases there is no need or it is impossible to reconcile expenditure to the finance provided under a financial instrument is strongly welcomed. This reflects the essential difference between loan/investment finance and grant. One example is when the purpose of a loan is defined in general terms (e.g., ‘expansion’, ‘modernisation’ or ‘internationalisation’). Another example shared during the session in this context was a scenario where a final recipient secures a saving against the expected cost of new machinery resulting in a EUR 10 000 saving. Under a financial instrument, it is legitimate for the final recipient to use this saving to purchase some related material without the need to amend the financing agreement (although some financial intermediaries might decide to amend the financing agreement with the final recipient). It was recognised that this was legitimate and such expenditure would nevertheless be eligible, whereas for a grant operation the opposite would be the case. This additional flexibility is justified by the nature of the repayable finance and the recognition of this in the audit methodology is important.

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