Final Report on the Pilot Study to Test the Methodology to Determine the Residual Error Rate for DG DEVCO

15 December 2011

1.   DRAFT EXECUTIVE SUMMARY

We have performed a pilot study designed to test the methodology proposed in the previous paper, *A Methodology and Costing for Approaches to Determining the Residual Error Rate for EuropeAid* prepared by Moore Stephens LLP in March 2011.

Residual Error Rate (RER) measurement seeks to quantify the errors affecting a population of transactions once all other possibilities for their detection are exhausted.

The Pilot Study was performed by drawing a sample of transactions from the 12,248 transactions relating to all 5,433 contracts – comprising all contract types - closed by EuropeAid in 2010. The sample was selected in three tranches, reflecting the proposal that RER measurement work should be performed in three separate stages. Performing the work throughout the year permits delivery of the final results in February, allowing for their consideration in the Director General's Annual Statement of Assurance.

Among the sample selected, ten were earmarked for detailed examination, with a view to testing the key methodological assumptions. A broad range of transaction types and geographic areas were selected to maximise the possibility of important lessons emerging. The key methodological assumptions set out in the original paper were:

- RER measurement should be based on examination of a statistically selected and evaluated sample of expenditure items;

- The sampling unit should comprise <u>transactions</u> incurred under closed contracts rather than the <u>closed contracts</u> themselves;

- Advance payments should be excluded from the sample population, and the sampling unit should be the 'accepted amount' recorded in CRIS;

- Sampling should be performed in three tranches throughout the year, with each trimestrial exercise resulting in an interim report and error evaluation. The results would then be consolidated for the whole year;

- The three trimesters should comprise the last four months of Year N-1, the first four months of Year N, and months 5 – 8 of Year N. This permits delivery of the results in time for consideration in the Statement of Assurance;

- The conclusion should be based on examination of 240 items (80 per trimester);

- Most RER work should be performed centrally, with relevant documentation provided electronically or physically repatriated. In limited circumstances, *in situ* fieldwork would be necessary, and around nine such missions (three per trimester) should be foreseen;

- The results of the exercise should produce a projected error rate, and an estimated Upper Error Limit based on 95% confidence.

Following performance of the Pilot Study, the proposed methodology remains broadly intact, although some refinement has taken place as a consequence. The refinements have been incorporated into the *Manual for Measuring the Residual Error Rate for EuropeAid*, and they include:

- Elaboration of the potential courses of action to be taken when information in respect of a selected transaction cannot be provided;

- Narrowing of the scope of the RER measurement exercise in respect of procurement activities where the European Commission acts as contracting authority;

- Amplification of the importance of clear, timely communications with Commission services responsible for administration of the transactions selected;

- Clarification of the required approach when the value of a transaction selected exceeds the sampling interval, and the effect on the overall number of items examined;

- Emphasis on the importance of prompt identification of previous control work performed in respect of selected transactions.

Following completion of the Pilot Study, we estimate that the average amount of time required to examine a transaction selected for RER measurement is six days. This estimate includes provision for administrative and technical costs relating to consolidation of results, review, and reporting.

The original methodology foresaw the involvement of experienced auditors, managers and an audit partner with an approximate ratio of 90:8:2, with an overall approximate daily time cost of €1,000. This assumption remains intact.

The original methodology foresaw on-the-spot work taking place in respect of approximately nine transactions each year. For performance of the Pilot Study, on-the-spot missions took place in two countries. In both cases, it was established that the work could have been performed at the auditor's premises. Nevertheless, the Pilot Study did provide evidence that

on-the-spot work should be performed in certain circumstances, and we continue to estimate that those circumstances would arise in respect of around 9 transactions.

In view of these estimates, we consider that a full-scale RER Measurement exercise, with examination of up to 240 transactions, would require resources amounting to a maximum of approximately € 1.5 million.[1]

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[1] (240 x 6 Days x €1,000) = € 1,440,000 + € 90,000 Mission Costs = € 1,530,000

2. INTRODUCTION TO THE ASSIGNMENT

2.1. Terms of reference

We have been engaged to:

- within the confines of the overall Commission internal control framework, test the methodology of calculation of the residual error rate on payments for all management modes under both EDF and General Budget by sampling at least ten transactions. Residual error rate is understood as the ratio of the amount of ineligible expenses remaining undetected, to the total amount of payments relating to contracts closed in a given 12-month-period.

- verify the feasibility of a full implementation of the methodology to measure the residual error rate, including adaptations to the methodology if necessary and, if appropriate, submit a revised estimate (compared with that mentioned in the methodology study) of its total cost.

- Elaborate a detailed step by step work programme/manual walking through the testing, assessment and reporting activities, including checklists, error definitions and evaluations and their financial impact, for the full implementation of the methodology to measure the residual error rate with such a degree of detail that any qualified auditor can perform the full implementation of the methodology. The work programme/manual should also address issues such as sampling techniques, sample sizes and possible expected coverage and be compatible with the European Court of Auditors' methodology.

On this basis, our report contains the results of the testing of the proposed methodology through the selection of a full sample of transactions across three trimesters of activity, the detailed examination of ten transactions, and an illustrative evaluation of the errors detected.

We have also prepared a manual, which is contained in the report *A Manual for Measuring the Residual Error Rate for EuropeAid*. This further develops the methodology that was set out in our earlier report, *A Methodology and Costing for Approaches to Determining the Residual Error* prepared by Moore Stephens LLP in March 2011.

2.2. A Summary of the Methodology set out in the Moore Stephens Report

Residual Errors are those that have evaded all prevention, detection and correction controls in the existing control framework. In the context of the European Commission this means that only transactions related to closed contracts should be examined when assessing the RER. Transactions related to open contracts still have the possibility of correction or amendment and are not included in the exercise.

A Transaction is an individual item recorded in CRIS which has an invoice reference.

The methodology suggests scrutiny of transactions incurred under contracts closed during the last four months of the year prior to the year in question (Year N-1), plus the first eight months of the year in question (Year N). This twelve-month period is split into three four-month trimesters. For each trimester, a sample is chosen, substantive work performed and an interim report prepared on the residual error rate identified. At the end of the testing, a final report aggregates these reports and provides an estimated measurement of the error rate for the twelve months under consideration.

Once a population of all transactions incurred under closed contracts has been identified, the steps to be taken in selecting the sample are as follows:

1. Confirm that all contracts were closed in the period;

2. Identify and list all transactions;

3. Remove pre-financing transactions from the population;

4. Identify the number of items that need to be examined to provide desired level of assurance;

5. Select items from detailed transaction listing using Monetary Unit Sampling (MUS), using the 'accepted amount' as the sampling unit.

Once a sample of transactions has been chosen, the results of previous control work, including audits, already performed on expenditure selected for examination provide the most important means of obtaining information that will permit the quantity of substantive work performed to be reduced. There is considerable scope for reducing the amount of substantive work that will need to be performed in respect of a selected contract if it has been the subject of demonstrable, detailed previous examination. The contribution made by existing controls would need to be determined shortly after sample selection, and so the ability to identify the previous performance of external audits and ex-post controls is vital.

While performing the transaction testing, field visits to delegations will not be performed routinely, although provision is made for up to three Delegations to be visited as part of each sampling tranche if the characteristics of the transactions selected indicate that *in situ* work would be beneficial (e.g. if repatriation of documentation would clearly be uneconomical, or if physical inspection of outputs is essential to obtain satisfactory evidence).

Once the substantive testing has been finalised, error evaluation should be performed in accordance with MUS principles.

2.3.   Costing Estimate

The original methodology set out in the March 2011 Moore Stephens report assumed that much of the substantive work would be performed by auditors with at least 3 years' aduit experience, supervised by Managers with at least 6 years' audit experience, with overall responsibility resting with an experienced Partner. The involvement of each staff type would be in accordance with the following approximate ratio: 90:8:2. This equates to an average approximate daily time cost of € 1,000.

Based on the type and complexity of work encountered during the pilot study, the assumption regarding the ratio of staff types needed to perform the RER assessment remains.

Furthermore, the methodology set out several options on how the RER assessment should be performed, with the most important factor affecting cost being the number of the transactions to be tested. The pilot study assumed that DEVCO would seek to test a maximum of 240 transactions, rather than entire contracts, and that the time to test an average transaction would be approximately five days.

Following completion of the pilot study, these assumptions remain broadly intact. As expected, testing of some transactions required considerably more time than the estimated five days, while certain transactions required less than the estimated five days. However, even where detailed substantive work relating to a transaction is limited to a short period of time, each transaction nevertheless requires substantial time relating to liaison, planning, documentation, and review. Consolidation of overall results, review and reporting is also time-consuming. Accordingly, we have therefore revised our estimate of the total amount of time required per transaction to six days. This estimate includes provision for administrative and technical costs relating to consolidation of results, review, and reporting. It does not, however, include the incremental costs resulting from on-the-spot examination of transactions (i.e. travel time, travel costs, and per diems).

The amount of time spent on an average transaction can be broken down as follows:

Activity	Days
Correspondence	0.5
Evaluation of Existing Control Work	0.5
Planning, including revision of audit programmes	0.5
Documentation and completion	0.5
Review	0.5
Substantive testing	3.5
TOTAL	**6.0**

It is important to note that this breakdown is indicative only, and that, when performing an exercise such as this, very few transactions can be described as 'typical' or 'average', since there are so many different contract types. It is the quantity of substantive testing required which is subject to the greatest variation between transactions – the amount of substantive testing required can vary from as little as half a day to several weeks' work in certain circumstances. Other activities are less likely to vary significantly.

Applying the average transaction sampling time to the maximum required sample population of 240 items would necessitate 1,440 auditor days' work, with an approximate maximum cost of € 1,440,000 plus costs relating to on-the-spot work.

3. WORK PERFORMED AS PART OF THE PILOT STUDY

3.1. Population data

The Data Warehouse Team from DG DEVCO provided the pilot auditors with a full listing of all transactions for contracts closed in 2010 at the end of December 2010. This was provided to facilitate the drafting of the report *A Methodology and Costing for Approaches to Determining the Residual Error*.

In order to better recreate the conditions that an RER auditor would face, it was decided to split the population into three four-month trimesters. Whilst trying to do this, it was established that the population listing previously given had no indication of invoice date, payment date or, most importantly for RER audit purposes, contract closure date. After contacting the Data Warehouse Team to provide this extra information, they informed us that the 2010 transaction listing we had previously been given was not definitive, resulting in provision of an updated transaction listing in May 2011.

After analysing this data, we established that there were minor differences between the listings, as follows:

	Per data extracted in December 2010	Per data extracted in May 2011	Difference
Expenditure accepted (€)	3,711,115,997	3,704,562,060	(6,553,937)
Number of transactions relating to closed contracts	11,277	12,248	971
Number of contracts closed in 2010	5,509	5,433	(76)

The implication of these differences is that contracts that had been closed during 2010 were subsequently reopened. This shows that, in practice, the closure of a contract in CRIS is not always the final administrative act relating to that contract. This means that during the live performance of the RER evaluation, the auditor must set a time when the data should be considered final for the purposes of evaluating the RER.

Once these additional data were provided, the coding of the listed transactions enabled the team to identify all prepayments in the listing. These were easily identified by the code 'AV' in the invoice type column of the listing. These payments were excluded from the population to be sampled in line with the methodology.

At this stage the RER audit team performed a number of checks on the integrity of the data provided, including:
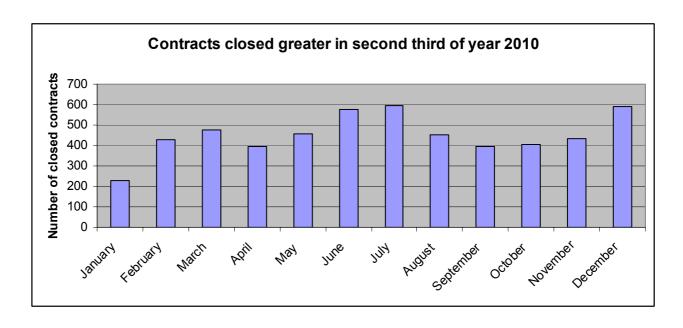
- They examined the transaction listing and considered whether there were obvious flaws in the data provided.

- They also ensured that the columns 'Status' and 'Invoice Type' for each transaction read 'Closed' and 'FAC' respectively. This ensured that there were no transactions relating to open contracts or pre-financing transactions in the listing.

- They ensured that the totals of 'Paid Amount' and 'Cleared Amount' combined were not significantly different from the total 'Accepted Amount'.

Finally, each transaction listed contained the date on which the contract related to it was closed. This enabled the auditors to extract a listing of all transactions that related to contracts closed during the first four months of the year. This was then repeated to produce a listing of the second and final trimesters of 2010. This was done to exactly recreate the testing in three tranches that would occur in the 'live' RER assessment.

3.2. Selection of sample

Once the three populations had been identified (one for each trimester), the RER audit team applied monetary unit sampling (MUS) techniques.

It had been previously agreed that the sample of transactions to be selected would be 240 for the pilot study, of which 10 would be substantively tested. The auditors analysed the transaction data which showed the following:

Contracts closed greater in second third of year 2010

Although the second trimester had a greater number of closed contract and transactions, the variance was not sufficiently significant to adjust the number of planned sampling intervals. It was therefore decided to choose a sample based on each trimestrial population containing 80 sampling intervals.

To perform monetary unit sampling the total euro value of accepted amounts for the trimester was divided by the number of sampling intervals (80). This provided an interval value. A random number generator was used to provide a starting point for the sampling.

A total of 208 individual transactions were selected from the 240 sampling intervals (the difference of 32 being accounted for by budget support transactions with a value greater than the sampling interval).

Summary information on transactions selected

	Trimester 1		Trimester 2		Trimester 3	
	Number of transactions	€	Number of transactions	€	Number of transactions	€
Total	67	318,247,806	72	480,235,839	69	383,179,891

3.3. Selection of transactions to test substantively

From the dummy sample of 208 transactions, a sub-sample of ten transactions was selected. This was a judgemental selection, where the auditors sought to choose transactions which related to a wide spread of contract types and locations, for the purposes of ensuring that the

greatest range of issues challenging the presumptions made in the methodology could emerge. Of these ten, a further two were selected to be tested 'on-the-spot'.

At this stage, the auditors were using the transaction listing data from CRIS to make this judgemental selection, but had not yet obtained all files archived in CRIS.

There were some errors in the data listed, confirming the risk identified in the methodology that narrative data recorded in CRIS is not always reliable:

- For the Jamaica transaction (DCI-SUCRE/2010/009-043), CRIS listed this transaction as an Action Grant but it was in reality a contract to provide Sector Budget Support.

- FOOD/2005/101-198 All Countries was coded as an 'action grant to any entity except International Organisations.' It was, in fact, an agreement with the FAO (Contribution Agreement).

These errors came to light only when the auditors had full access to documentation stored in CRIS. With this added information, it was obvious that too many transactions related to budget support contracts had been chosen to examine during the pilot so it was decided to substitute a different transaction.

In the 'live' exercise, all transactions would be tested. However decisions would still need to be made about which transactions to examine 'on-the-spot' and professional judgement should be used. It is clear that this judgement cannot be made based on the information contained in the transaction listing alone. Although initial plans can be made to perform on-the-spot testing upon receipt of the transaction listing and sample selection, final decisions should not be made until reliable contractual and reporting information relating to the transaction has been examined (see Instruction Manual for further elaboration on this point).

3.4.   Communication with Delegations/ Units

Requests for documentation were sent to the ten Delegations/ Units responsible for the contracts at the end of May 2011. Although documentation was received for nine of the contracts, in some cases there were lengthy delays. In one case, no reply was received. In

another case, some of the requested documentation had been destroyed and in a further case the documentation did not arrive in time to be included in the pilot study.

We consider that the impact of such non-provision of documentation on a 'live' exercise would be less serious than the results of the pilot study imply. Although a high proportion of transactions examined (3 out of 10) were affected by difficulties in obtaining information, we do not consider that such a proportion of transactions in a full-scale exercise would be affected because:

1. The full-scale exercise would be preceded by formal communication from DEVCO Headquarters informing Delegations and Units of the forthcoming performance of the RER exercise, and providing instructions on how to comply with the demands of the exercise; and

2. The time scale for performance of the full scale exercise would have more flexibility, at least in respect of transactions selected in the first and second trimesters (conclusions in respect of those transactions could be postponed until a subsequent trimester. While not a situation to be encouraged, it would provide some flexibility).

3. It was later established that the destroyed documentation would not have needed to be examined in any case, following clarification of the scope of RER audit work in respect of procurement exercises where the Commission acts as contracting authority.

Detailed information on the success of communication strategies and lessons learned are included in Section 4 for each transaction examined.

3.5.   Examination of previously operating controls

During the pilot study, all information and documentation was requested at the same time in an initial email.

In respect of the following transactions, we were able to obtain evidence of previous control work:

- FED/2004/186-695 Nigeria

- ONG-PVD/2008/007-550 Armenia

- FED/2010/041-190 Namibia

- MED/2005/114-991 Morocco

- MED/2005/113-773 Egypt

For the Nigeria transaction, the previous control work was a financial audit which partially covered the transaction. The RER auditors had access to the working papers and were able to establish the work performed was of satisfactory quality so reliance was placed on the audit work to the extent that it related to the transaction selected.

For the Armenia transaction, two audit reports had been produced. One was engaged by the beneficiary and the second was an ex post financial audit engaged by the Delegation. In both cases, the work was satisfactory both in scope and in quality. Had this been a 'live' assessment of the RER, it would have been suitable to place full reliance on the reports' conclusions.

For the Namibia transaction, the Delegation provided a final audit report. There were a number of factors which prevented reliance being placed on the report, *viz*:

- The Terms of Reference governing the engagement were insufficiently well developed, as the standards governing the performance of the audit work and the form of opinion were not stated. The Terms of Reference contained elements of engagement terms for both a financial audit and for an agreed-upon procedures engagement, without fully explaining the requirements for either.

- The audit report provided a conclusion only in a negative, limited assurance, form i.e. "*nothing has come to our attention to indicate that there are material levels of error…*" rather than the reasonable assurance formulation "*we are of the opinion that the underlying transactions comply, in all material respects, with the conditions of the contract…*" . For RER purposes, it is difficult to envisage reliance being capable of being placed on work which has a conclusion providing only limited assurance.

- Substantive work performed by the auditors comprised an examination of 30 transactions to examine whether key controls were in place. The work focused on high value items in order to achieve that level of coverage. More focused substantive testing is necessary to reach a reliable conclusion in respect of Programme Estimates, and the substantive testing performed by the RER auditors revealed that errors were concentrated among lower-value items.

For MED/2005/114-991 Morocco and MED/2005/113-773 Egypt, both Budget Support contracts, the RER auditors were provided with detailed correspondence and reports which showed review in Brussels of the decision to make payments by the Delegation. These reviews fully covered the transactions under scrutiny. In principle, during a 'live' RER assessment, it would be possible to place reliance upon this control work. However, since much of the RER assurance in respect of budget support items would be derived from consideration of such disbursement assessments in any case, there would be less of a reduction in the work that would otherwise have been performed (indeed, the absence of detailed disbursement assessments should not be expected in respect of budget support transactions).

4. INDIVIDUAL TRANSACTIONS EXAMINED - SUBSTANTIVE TESTING

4.1. Caribbean Region

Transaction No FED/2009/044-335 (Selex retention - Inv 091138 A/ 091138B/ 091138C under FED/2006/189-659, SUPPLY OF 4 RADARS - SELEX SYSTEMI INTEGRATI GMBH), € 514,964.00

The Contract

This contract was a supply contract for the supply and installation of four radars in four different countries for the Caribbean Meteorological Organisation. The individual transaction selected was for a value of € 514,964.00 and the amount incurred under the contract in total was € 6,664,405.

Communication with Delegation

The Delegation was contacted in late May. In their reply, they explained that they would not be able to provide documentation before mid July. In reality, all documentation was received by late June. However, the documentation received was not sufficiently complete to allow the auditor to perform full testing of the procurement process. The auditors made a further request and the necessary documentation was sent electronically.

Had the initial request for information been framed to recognise the specific requirements of a supply contract – rather than a generic request for all contract types – then it is likely that complete documentation would have been provided in the first instance.

Results

The substantive testing showed no residual error.

Lessons learned

- The supply contract under scrutiny was for the supply of radar systems. The procurement was performed by staff and TA from the Caribbean Meteorological Organisation. The technical assessment of the procurement exercise was complex and it would be impossible for an auditor to re-perform the exercise in full, although any significant issues would be re-examined. We were able to check the credentials of experts who examined technical compliance at the time, and place reliance

accordingly. However, in the absence of this possibility, an auditor would be justified in considering using a third party expert if he did not feel he had the necessary expertise.

- The volume of documentation was compact enough to send all information in a number of zipped files. There would be no compelling reason to perform this work on site.

- The European Commission was a third party signatory to the contract and did not directly perform the procurement of the radar systems so non-compliance with procurement requirements could have resulted in ineligibility, which would in turn result in a residual error.

4.2. Russia

Transaction No TACIS/2006/014-480 (interim payment under TACIS/2004/071-227, Construction of the Sludge Incineration Plant at the South West Waste Water Treatment Plant in St Petersburg), € 1,855,285.71

The Contract

This contract was a works contract for the construction of a sewage works in St Petersburg. The Commission was a co-signatory to the contract and performed all procurement processes directly and administered all payments. The individual transaction selected was for a value of € 1,855,285.71 and the amount incurred under the contract in total was € 24,900,000.

Communication with Delegation

Although there was correspondence with the Delegation on the same day the request for documentation was sent, there were delays of over a month in sending the complete documentation, which was sent in two batches. This was due to a busy period for officers in the Operations Unit. Once the documentation was received, it was found to be incomplete. The procurement officer explained that Delegation staff had destroyed tender documentation from the year 2004. This meant that a full evaluation of the tender for the works contract could not be performed. It was subsequently established, through confirmation from EC officials at DEVCO HQ, that examination of such documentation would not have been necessary in any case, since procurement was performed by the Commission directly, and no recovery order could have resulted from a failure to apply appropriate procurement procedures. Accordingly, such procurement exercises are excluded from the scope of the RER measurement exercise.

Results

The substantive testing showed no residual error.

Lessons learned

- The European Commission was a third party signatory to the contract and performed all tendering procedures directly. Accordingly, scrutiny of adherence to required procurement procedures was not required.

- Although the documentation destroyed was not required to test the transaction in this instance, should widespread instances of disposal of documentation be detected during a full-scale RER exercise, then successful RER measurement could be

threatened. This consideration has led to elaboration of the RER auditor's response to missing/inaccessible documentation in the Instruction Manual.

4.3. Nigeria

Transaction No FED/2010/021-081 (Final Clearance under FED/2004/186-695 Partnership to Reinforce Immunisation Efficiency - Support to Polio National Immunisation Days (NIDS) with WHO) € 12,376,649

The Contract

The contract was a grant contract with the World Health Organisation under a Financing and Contribution Agreement. The contract was intended to support an immunisation campaign through National Immunisation Days, and ultimately to rid Nigeria of the polio virus. This is a rare case where the Commission had a specific, contractual right to audit work performed by a UN agency. The Specific Conditions to the Contribution Agreement stated that € 7,655,325 of the total amount of € 12,900,000 can be reviewed and audited. The individual transaction selected was for a value of € 12,376,649 and the amount incurred under the contract in total was € 12,376,649.

Communication with Delegation

The audit team was sent very little project documentation on the WHO grant contract. This included two audit reports and the grant contract. The RER auditors had access to the working papers and were able to rely upon the audit report. The Delegation informed the team, however, that it would be unable to obtain documentation supporting the remaining € 5.2m not covered by the audit report.

Results

Restrictions on access to documentation prevented performance of full substantive procedures in respect of expenditure incurred directly by the WHO and not subject to an audit report, which was € 5,244,675. As a result of this it was decided to apply the error rate from previous control work performed on the remainder of the project using the "estimation method" described in the Instruction Manual. The previous audit work revealed an error rate of 3.1%. Applying this rate to the unaudited amount of € 5,244,675 would leave a residual error of € 162,769.

Lessons learned

- Although implementation of the project was dispersed throughout Nigeria, documentation was located at the WHO in Nigeria. Had there been no audit report, there may have been a benefit to performing fieldwork. However, considering the administrative complexity of gaining access to documentation controlled by UN entities, this benefit may have been outweighed by the practical and regulatory complications.

- As we were unable to perform detailed substantive testing on unaudited expenditure of €5.2m, it is arguable that there is a limitation of scope. This consideration enabled us to refine the RER auditor's response to instances where substantive procedures cannot be performed in full, resulting in the "Exclude, Substitute or Estimate" methods described in the instruction manual.

As the project was subject to previous control work, and it was considered that the unaudited expenditure shared characteristics with the audited expenditure which meant that a similar rate of error could be expected, the Estimation Method was applied.

The use of this method (as with any of the other 2 responses to insufficient documentation) would need to be accompanied by full and detailed disclosure of the circumstances surrounding the use of the chosen method, and a sensitivity analysis showing the effect of different error rates to that applied to the transaction on the overall Residual Error Rate.

4.4. Egypt

Transaction No MED/2009/056-324 (Water Support Reform Program - Disbursement of third tranche under project MED/2005/114-991), € 18,336,835

The Contract

The contract is a budget support contract with the Egyptian Government to facilitate reform of the water supply in the country and improve its quality. The individual transaction selected was the third payment under the contract for a value of € 18,336,835 and the amount of expenditure incurred under the contract in total was € 78,336,835.

Communication with Delegation

Although a full list of documentation was requested from the Delegation, in order to get the correct and complete information required, two follow up emails were needed.

Had the initial request for information been framed to recognise the specific requirements of a budget support contract – rather than a generic request for all contract types – then it is likely that complete documentation would have been provided in the first instance.

Results

The substantive testing showed no residual error.

Lessons learned

- The volume of documentation was compact enough to send all information in a number of zipped files. There was no reason to perform this work on site.

- Detailed lists of documentation, which are drafted with the specific contract in mind, would be required to save time in following up information requests.

4.5.   Jamaica

Transaction No DCI-SUCRE/2010/009-043 (Sugar Cane Sector budget support 2007 component - Disbursement of third tranche under project DCI-SUCRE/2008/162-772) - € 2,625,000

The Contract

The contract is a sector budget support contract with the Jamaican Government to provide support to reform of the sugar industry in the country. As some eligibility conditions had not been previously met for a previous payment, the contract had been amended to allow the Ministry an extra year to meet the conditions. The individual transaction selected was the third payment under the contract for a value of € 2,625,000 and the amount incurred under the contract in total was € 12,440,000.

Communication with Delegation

All information required was sent quickly and with no need for follow up.

Results

The substantive testing showed no residual error. CRIS listed this transaction as an Action Grant but it was actually a contract to provide Sector Budget Support.

Lessons learned

- The volume of documentation was compact enough to send all information in a number of zipped files. There was no reason to perform this work on site.

4.6.   Morocco

Transaction No MED/2005/026-204 (Programme d'appui sectoriel à la résorption de l'habitat insalubre au Maroc MED/2005/113-773), € 30,000,000

The Contract

The contract is a sector budget support contract with the Moroccan Government to provide support for improving the living conditions of the country's people. The individual transaction selected was the first payment under the contract for a value of € 30,000,000 and the amount incurred under the contract in total was € 85,700,000.

Communication with Delegation

All information required was sent quickly and with only a small number of follow up questions.

Results

The substantive testing showed no residual error.

Lessons learned

- The volume of documentation was compact enough to send all information in a small number of files by email. There was no reason to perform this work on site.

4.7.   Namibia

The Contract

The contract is a Programme Estimate designed to support the Namibian Government and other bodies to develop their multi-sectoral approach to HIV/ AIDS. The individual transaction selected was the final clearance of € 145,514.45 and the amount incurred under the contract in total was € 346,447.28.

Communication with Delegation

The testing for this transaction was performed 'on-the-spot' and the Delegation provided documentation necessary to prepare for the mission without delay. All documentation relating to the project was held at the Delegation, and it was easily accessible.

Results

The Programme Estimate was the subject of a previous audit. No reliance could be placed on the audit report, however, since:

- The Terms of Reference governing the audit work were insufficiently well developed;

- The audit report gives only limited assurance (rather than reasonable assurance);

- The scope of the work performed was inadequate, and appeared to result in any assurance only in respect of higher-value items;

- The substantive testing performed by RER auditors revealed errors that were not identified by the previous audit.

Ineligible expenditure was detected through application of substantive procedures in respect of a number of items, including:

- A double payment;

- Unsupported travel costs;

- Expenditure unrelated to project activity; and

- Inadequate supporting documentation.

The error rate affecting this transaction was 1.38%

The work also revealed anomalies in the data recorded in CRIS:

- Previous transactions made under this contract were mis-posted in CRIS: a replenishment was incorrectly recorded as an advance, and clearances were performed gross of VAT. As a consequence of the VAT-related mis-postings, the final clearance of € 145,514 did not match the underlying activity to which the transactions relates, since the previous VAT-related errors were corrected as part of the same transaction. See narrative and table below for further explanation of the consequences of this.

- Upon the migration from OLAS to CRIS, historic transaction data was not recorded in a way that permitted it to appear in the transaction listing from which the RER sample was selected. As a consequence, earlier transactions recorded under this contract could not have been selected for examination.

Lessons learned

Although Programme Estimates are a contract type where *in situ* examination of documentation is most likely to be desirable, in this instance the work could have been performed centrally at the auditor's premises.

- There were no tangible programme outputs to examine;

- The project had been disbanded, and so project staff were unavailable (their input was not required in any case);

- None of the current delegation personnel had any involvement in the programme;

- The volume of documentation related to the programme was, though large, not excessive (8 Lever Arch Files), and could have been repatriated to Europe, and then sent back to the Delegation at a cost which would have been inferior to the cost of performing an *in situ* mission.

The anomalies in the CRIS data (described above) have the following implications for the methodology:

- Full checks on the completeness of data from which the RER sample is selected are required; and

- Where amounts recorded in CRIS do not match the underlying activity/ financial report, the error evaluation must be 'flexed' (i.e. the error rate relating to the relevant financial report must be applied to the sampled amount, rather than the error amount). The table below gives an example of how this principle was applied to this transaction.

	Transaction		Error		
	€	NAD	€	NAD	%
Amount Tested		1,550,428	N/A	21,342	1.38%
Less: VAT Refund		(169,587)			
Less: Other reimbursements		(15,159)			
		1,365,682			
Final Clearance	145,514	1,365,682	2,003	18,799	1.38%

Substantive audit work revealed that, of NAD 1,550,428 reported expenditure, NAD 21,342 was ineligible, amounting to 1.38%.

The reported expenditure was subject to adjustment before recording in CRIS took place, and the error rate of 1.38% was applied to the amount recorded in CRIS, giving a residual error of € 2,003.

4.8.   All Countries

Transaction No FOOD/2009/060-615 (first payment under FOOD/2005/101-198- Contribution to the multiannual EC FAO programme "Food Security Information for Action"),   €5,626,688.55

The Contract

The contract is a grant contract signed with the Food and Agriculture Organisation of the United Nations to provide support to information systems involved in monitoring food security. The individual transaction selected was the final clearance of expenditure under the programme for € 5,626,688.55 and the amount incurred under the contract in total was € 9,875,721.

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Communication with Delegation

An request for documentation for this contract was sent to the relevant Unit in late May. Despite a number of follow up emails, there was no response from the Unit by the end of the pilot study. The documentation archived in CRIS was too basic to allow any detailed testing.

Results

All transactions under this contract were coded as for an 'action grant to any entity except International Organisations' when the governing contract was in fact an agreement with the FAO (an International Organisation).

As there was no documentation provided to the audit team, it is impossible to make any assessment over whether there was a residual error.

Lessons learned

As shown in the Nigeria section above, this transaction illustrates the risks to effective RER measurement presented by non-availability of documentation. In this instance, it appears that documentation was not made available for RER purposes due to a lack of clarity as to the

identity of the officials responsible for custodianship of relevant documentation. It is likely that the clear instructions and guidance issued by DG DEVCO HQ in advance of a full-scale RER exercise would encourage nomination of an appropriate officer.

This state of affairs would appear to support a "substitution" approach to the transaction, if the absence of an appropriate EC contact persisted, in accordance with the revised methodology described in the instruction manual. A similar transaction would be selected to replace the originally selected transaction. Such a replacement transaction would need to share key characteristics with the originally-selected items (i.e. a transaction of similar monetary importance with an international organisation, subject to the restrictions imposed by the FAFA or similar). Naturally, this course of action can only be taken if there is no indication that the lack of documentation disguises a risk of presence of serious error.

Moreover, since the time-frame for performance of the pilot study did not permit re-selection of another replacement transaction, this item was excluded from the overall error evaluation in section 5.

4.9.   South Africa

Transaction No AFS/2006/009-753 (WYG International interim payment under AFS/2004/085-152, PMU- local economic development support in the Kwazulu Natal Province, Republic of South Africa) € 1,280,292.50.

The Contract

This contract was a service contract relating to the running of a Programme Coordination Unit by WYG International. This was set up to manage local economic development support in the Kwazulu Natal Province. The individual transaction selected was for a value of € 1,280,292.50 and the amount incurred under the contract in total was € 13,458,795.

Communication with Delegation

There were some delays in replying to the requests for documentation. The audit team received most of the necessary documentation in late July 2011. Additional documentation was requested which was received in August 2011. At the time of writing there was still a request for supporting documentation outstanding.

Had the initial request for information been framed to recognise the specific requirements of a service contract – rather than a generic request for all contract types – then it is likely that complete documentation would have been provided in time to complete procedures.

Results

At the time of writing, the timesheets supporting the fees charged under the service contract had not yet been provided to the RER auditors. It was not, therefore, possible to form a firm conclusion on the presence of residual error. In accordance with the practice prescribed in the Instruction Manual, we excluded the item from the error evaluation: although documentation was not complete, the transaction concerns a relatively low-risk transaction type, and moreover we understand that the documentation will be presented in due course. Accordingly, exclusion is an appropriate course of action, provided that such an exclusion is accompanied by clear disclosure of the circumstances surrounding exclusion, and a clear

indication of the effect on the overall Residual Error Rate were the transaction included with a high rate of error.

Lessons learned

- This transactions illustrates the importance of explaining the nature and purpose of RER evaluation to the Delegation or Unit concerned at the initial stage, and initial provision of a more refined request for information would have better equipped the Delegation to identify all relevant documentation without delay. Although documentation was provided, certain key items were not present.

4.10. Armenia

Transaction No ONG-PVD/2008/007-550 (Final Payment under ONG/PVD/2003/061-435, BUILDING SUSTAINABLE RURAL LIVELIHOODS IN TAVUSH REGION, ARMENIA), € 421,364.70.

The Contract

This contract was a grant contract with World Vision Deutschland relating to a project which would support economic development in the Tavush region of Armenia. The individual transaction selected was for a value of € 421,364.70 and the amount incurred under the contract in total was € 707,691. The transaction was audited in Yerevan, Armenia at the Delegation and premises of World Vision.

Communication with Delegation

The Delegation officials were able to arrange the inspection of documentation. There were some delays in performing the work as the Beneficiary was fully engaged in another audit, so the work was delayed to mid July 2011.

Results

The substantive testing showed no residual error.

Lessons learned

- The documentation for this contract was held primarily at the beneficiary premises in archive. Due to the volume of files and complexity of filing it would have been a very time consuming exercise to send all documentation centrally (there were 5,000 individual transaction items stored in around 100 files). In this instance, to find supporting documentation for every single transaction (rather than just a sample) would have taken several weeks of administrative work. As certain documents have to be retained locally, there would also have been a large element of scanning/ copying. Although it is preferable that all transactions should be audited centrally, in

instances such as this – and where no other control work upon which reliance can placed is present – on-the-spot work would seem to provide the only practical means of obtaining the necessary evidence.

- In this instance, almost every piece of documentation was available in English and Armenian. In other instances, it is likely that the auditor may need to speak a local language to perform the work. The RER auditor will therefore have to consider the language skills of the proposed team.

- The Delegation officials gave the auditors feedback on how they believed the communication with them should be carried out. They stated that the Delegation staff should be given as full information as possible on the RER exercise and benefits attached to it. As the RER assessment may cause a substantial administrative burden to Delegations/ Units, this is vital. They also requested more information on how the sample had been selected. Finally, they stated that the initial contact should be made to the Head of Finance and Contracts.

- The auditor should seek to reduce any burden on the beneficiary. In this instance, it was the third time that the project had been subjected to audit or audit-style procedures. The pilot study, in this instance, could have relied upon the previous audit work performed. The methodology should be adapted to include a two-stage request for information (previous control work first then if necessary, a request for further documentation).

5.   ILLUSTRATIVE CALCULATION OF THE RESIDUAL ERROR RATE

Once the results of the testing of the ten transactions were available, a list of errors was produced. Because the number of transactions examined was low, 'dummy' errors were added to the listing of residual errors based on the wider population of sampled transactions.[2] This list was then used to calculate the residual error rate for each trimester, as if that calculation were being performed at the end of the work relating to that trimester. Errors which were actually found during the pilot are italicised in the listing.

The dummy errors from contracts closed during the three trimesters of 2010 were as follows:

Error Rate Calculation (First Trimester)

A	B	C	D(B – C)	E (D x B)	F (E x I)
Transaction Ref	Recorded Amount	Correct Amount	Difference	Error Rate	Projected Error
ASIE/2009/060-475	1,052,805	1,002,805	50,000	4.8%	633,125
FOOD/2007/006-285	319,105	219,104	100,001	31.3%	4,177,734
MED/2010/002-506	4,745,424	4,245,424	500,000	10.5%	1,404,642
MIGR/2010/007-379	541,697	509,550	32,147	5.9%	791,142
FED/2009/210-691	77,278	75,109	2,169	2.8%`	374,166
ONG-PVD/2005/094-700	308,600	258,600	50,000	16.2%	2,159,955
					9,540,754

No of Sampling Intervals	79	G	Excluded South Africa transaction	
Population Value	1,053,168,214	H	Total Contracts Closed Jan – Apr 2010	
Sampling Interval	13,331,243	I	H/G	
Projected Residual Error (€)	9,540,754	J	Sum of Individual Projected Errors	
Projected Residual Error (%)	0.91%		J/H	

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[2] For the sake of clarity, the number of 'dummy' errors has been kept to a minimum, with a view to producing an overall Residual Error Rate of around c.1%. In a 'live' full-scale exercise, it is likely that the number of errors would be higher than illustrated here, although individual transaction error rates would be likely to be much lower. Error rates affecting individual transactions have been exaggerated here to produce the overall result of 1%. The 'dummy' errors used here were produced in order to illustrate the overall error evaluation using data drawn from three trimesters – they should not be regarded as being, or attempting to be, representative of the individual transaction error rates found in the actual population, except where errors were actually detected as part of the pilot study.
Moreover, no attempt has been made to estimate the number of transactions where documentation would not be made available in a full-scale exercise.

Error Rate Calculation (Second Trimester)

A	B	C	D(B – C)	E (D x B)	F (E x I)
Transaction Ref	**Recorded Amount**	**Correct Amount**	**Difference**	**Error Rate**	**Projected Error**
AFS/2007/016-322	4,115,593	4,085,593	30,000	0.7%	125,622
FED/2010/021-081	*12,376,649*	*12,213,880*	*162,769*	*1.3%*	*226,644*
TACIS/2001/004-493	6,660,000	6,560,000	100,000	1.5%	258,763
FED/2009/051-298	151,339	45,000	106,339	70.3%	12,109,271
					12,720,300

No of Sampling Intervals	79	**G**	All Countries transaction removed	
Population Value	1,361,454,751	**H**	Total Contracts Closed May – August 2010	
Sampling Interval	17,233,604	**I**	H/G	
Projected Residual Error (€)	12,720,300	**J**	Sum of Individual Projected Errors	
Projected Residual Error (%)	0.93%		J/H	

Error Rate Calculation (Third Trimester)

A	B	C	D (B – C)	E (D x B)	F (E x I)
Transaction Ref	**Recorded Amount**	**Correct Amount**	**Difference**	**Error Rate**	**Projected Error**
MIGR/2010/032-559	455,658	421,526	34,132	7.5%	1,207,939
DDH/2008/005-505	804,858	714,858	90,000	11.2%	1,803,220
AFS/2002/004-110	1,254,504	1,233,504	21,000	1.7%	269,947
FED/2010/041-190	*145,514*	*143,514*	*2,004*	*1.4%*	*221,690*
ONG-PVD/2010/042-476	735,187	705,186	30,001	4.1%	658,048
SANTE/2008/002-293	1,408,417	950,500	457,917	32.5%	5,243,011
MED/2010/024-364	35,330	18,000	17,330	49.1%	7,910,071
					17,313,927

No of Sampling Intervals	80	**G**		
Population Value	1,290,076,471	**H**	Total Contracts Closed Sept – Dec 2010	
Sampling Interval	16,125,956	**I**	H/G	
Projected Residual Error (€)	17,313,927	**J**	Sum of Individual Projected Errors	
Projected Residual Error (%)	1.34%		J/H	

Error Rate Calculation (Whole Year)

Having produced individual projected Residual Error Rates for each trimester, the data was re-assembled and re-evaluated to calculate the projected Residual Error Rate for the entire year.
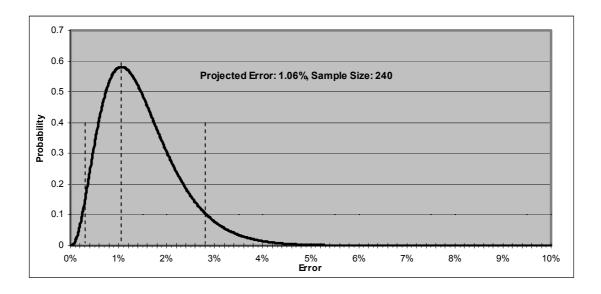
A	B	C	D(B – C)	E (D x B)	F (E x I)
Transaction Ref	Recorded Amount	Correct Amount	Difference	Error Rate	Projected Error
ASIE/2009/060-475	1,052,805	1,002,805	50,000	4.7%	739,255
FOOD/2007/006-285	319,105	219,104	100,001	31.3%	4,878,049
MED/2010/002-506	4,745,424	4,245,424	500,000	10.5%	1,640,103
MIGR/2010/007-379	541,697	509,550	32,147	5.9%	923,751
FED/2009/210-691	77,278	75,109	2,169	2.8%	436,888
ONG-PVD/2005/094-700	308,600	258,600	50,000	16.2%	2,522,029
AFS/2007/016-322	4,115,593	4,085,593	30,000	0.7%	113,466
FED/2010/021-081	12,376,649	12,213,880	162,769	1.3%	204,713
TACIS/2001/004-493	6,660,000	6,560,000	100,000	1.5%	233,723
FED/2009/051-298	151,339	45,000	106,339	70.3%	10,937,497
MIGR/2010/032-559	455,658	421,526	34,132	7.5%	1,165,992
DDH/2008/005-505	804,858	714,858	90,000	11.2%	1,740,601
AFS/2002/004-110	1,254,504	1,233,504	21,000	1.7%	260,573
FED/2010/041-190	145,514	143,514	2,004	1.4%	213,992
ONG-PVD/2010/042-476	735,187	705,186	30,001	4.1%	635,196
SANTE/2008/002-293	1,408,417	950,500	457,917	32.5%	5,060,941
MED/2010/024-364	35,330	18,000	17,330	49.1%	7,635,385
					39,342,154

No of Sampling Intervals	238	G	Excluded two South Africa and All Countries transactions
Population Value	3,704,699,436	H	Total Contracts Closed 2010
Sampling Interval	15,565,964	I	H/G
Projected Residual Error (€)	39,342,154	J	Sum of Individual Projected Errors
Projected Residual Error (%)	1.06%		J/H

Although the errors shown here are based substantially on dummy errors, and should be treated with the caution advised in footnote No 2 above, the profile of the errors nevertheless illustrates the effect of individual errors detected on the overall projected Residual Error Rate. It may be thought surprising that the overall projected error rate is so low (1.06%) when some of the individual errors identified are far larger (e.g. 70.3%). It must be remembered that the list above shows only the 17 sampling intervals where any error at all was detected. These items are vastly outnumbered by the 221 intervals where no error is recorded. Nevertheless, it is clear that the measurement of the overall Residual Error Rate depends on the results relating to a relatively small proportion of the total transactions examined.

Error Rate Chart

The results of the dummy error evaluation can be presented graphically as follows:

With a projected error of 1.06% and a sampling interval of 238, the Upper Error Limit at 95% confidence is 3.0%

6.   CONCLUSIONS   REACHED   AND   EFFECT   ON   ORIGINAL METHODOLOGY

During the pilot study, the RER auditors were able to make numerous observations and conclusions. These have led to various adaptations of the original methodology, all of which are reflected in the manual which accompanies this report. Here follows a summary of conclusions reached during the testing of the methodology and the changes they have brought about in the methodology.

Extraction of population data and selection of sample

Whilst obtaining the population of transactions relating to closed contracts, we were provided with two versions. It became obvious that contracts were being reopened once they had been closed, meaning that the listing of transactions may not necessarily be definitive.

As a result of this, the methodology was adapted to ensure that the auditor sets a date on which the population is to be considered definitive.

It was noticed that the migration of data from OLAS to CRIS was flawed as in at least one case the CRIS listing which provided the sampling population was incomplete. As a result of this, certain transactions related to closed contracts would have no possibility of being chosen as part of a sample, since they are not included in the population from which the sample was drawn. There is no identifiable remedy to this, and this issue should be taken into account by DG DEVCO when interpreting the results of a full RER exercise.

Communication with Delegations/ Units

The pilot study emphasised the importance of effective communication with the Commission staff. Some transactions were affected by delays in provision of information relating to transactions selected, and in one instance no reply was received to attempts to obtain information. Furthermore, as the auditors had to follow up requests for documentation due to

misunderstandings where incorrect/ incomplete documentation was sent, effective communication can help reduce the administrative burden of the exercise.

Considering that a full scale exercise would be preceded by formal communications from DEVCO Headquarters to all Delegations and Units that would be required to provide information, and that there would be a possibility of postponing substantive work until a subsequent trimester, we consider that each transaction examined would be subject to a lower risk of non-provision of documentation than was the case during the pilot study. Nevertheless, the number of items to be examined in a full-scale exercise means that the overall risk of non-provision of documentation remains substantial.

The pilot study also showed that the methodology should be amended to emphasise the importance of clearly explaining the purpose and benefits of the RER exercise as obtaining documentation can be time-consuming and demanding.

Furthermore, the pilot study showed that documentation should be requested in two stages to eliminate wasted effort. Before requesting full documentation for a chosen transaction, the RER auditor should merely request documentation on all previous control work performed. It should be emphasised that if reliance can be placed on this work it may reduce the amount of detailed substantive work later.

Reliance on previous controls

The provision of reports showing the exercise of previous controls enabled the team to enhance the methodology regarding reliance on previous controls. There are three possible outcomes at this stage ('Complete', 'Partial', and 'None'.). The auditors had examined reports which could be relied on, reports which could not be relied upon and reports with limited scope which could be partially relied on. This decision has now been made a major part of the methodology.

Specific considerations whilst performing the testing of transactions

Whilst performing the pilot, the auditors were able to identify circumstances which may impair the abilities of the RER auditor to perform the assessment of individual transactions.

- **Language** During the performance of the Armenia 'on-the-spot' fieldwork, all documentation was available in Armenian and translated into English. If this had not

been the case, it would have been necessary to employ a translator or local auditor. An audit team performing the RER assessment would need to have a large and flexible team of capable linguists as the documentation received may not always be in a major European language.

- **Technical Capacity to Perform Work** In certain cases, such as the procurement of technical equipment or engineering work, an auditor may have to assess complex tender requirements or assess compliance with detailed technical specifications. The methodology was adapted to include the possibility of using an auditor's expert.

- **Location of Documentation** – The documentation for the World Vision contract in Armenia was archived and not held at the Delegation premises. Furthermore, finance staff were not immediately available to take the necessary documentation out of archive. In the light of this, the methodology was adapted to flexibility in the timetable so that any delays do not delay the assessment. In this instance, the auditor may consider performing on-the-spot fieldwork.

- **Access to documentation restricted for contractual/legal reasons**. Our experience of testing transactions related to contracts signed with United Nations Agencies brought up the possible limitation of access to documentation. Strategies to deal with this situation have been added to the methodology.

- **Delays in presenting documentation**. During the pilot study, there were delays in the provision of documentation. The methodology has been adapted to allow the possibility of work being performed in a later trimester. The pilot study itself was not able to benefit from this adaptation, since there was no possibility for postponement of work.

Procurement testing

During the testing of a works contract, the procurement documentation requested was incomplete. However, as the procurement was completed by the Delegation which paid for the works, it was decided that any non-compliance with the provisions of the Practical Guide would not give rise to a residual error. The methodology was updated to exclude the possibility of testing procurement when the Commission has performed it itself.

Considerations when calculating the residual error rate

During the pilot, transactions were selected where incomplete evidence meant the auditors were unable to obtain assurance that the transaction was free from residual error. The methodology was updated to deal with this possibility. The reason for the lack of evidence should be investigated and the circumstances for the missing evidence should be disclosed during reporting.

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Date: 15 December 2011

7. ANNEXES

7.1. Annex 1: List of transactions sampled and summary of results

Transaction Reference	Geographic Location	Recorded amount €	Correct amount €	Comment
AFS/2006/009-753	South Africa	1,280,292.50	Unknown	At the time of error evaluation, full documentation for this contract had not been received. However, it was concluded that it was likely that this type of transaction would be typically free from error, and that during performance of a full-scale exercise, documentation would have been provided in due course. Accordingly, the transaction was excluded from the overall error evaluation ("Exclusion" method).
FED/2009/044-335	Caribbean Region	514,964.00	514,964.00	No residual error.
TACIS/2006/014-480	Russia	1,855,285.71	1,855,285.71	No residual error.
FOOD/2009/060-615	All Countries	5,626,688.55	Unknown	No information was received from the unit responsible for implementation of this contract. However, it was concluded that following formal intervention from DEVCO Headquarters, documentation would have been provided in a full-scale exercise, and the transaction type was of a sort typically free from error. Where there is a clearly identifiable reason for non-provision of information, e.g. EC personnel rotation making identification of a suitable responsible official impossible, replacement of the transaction with another similar item is an appropriate response ("Substitution" method).
FED/2010/021-081	Nigeria	12,376,649.00	12,213,880	Due to the provisions of the FAFA, it was impossible to examine all expenditure relating to this transaction. In this instance, we applied the error rate of 3.1% implied by the previous control work to the unaudited population ("Estimation" method).
MED/2009/056-324	Egypt	18,336,835.00	18,336,835.00	No residual error.
DCI-SUCRE/2010/009-043	Jamaica	2,625,000.00	2,625,000.00	No residual error.
FED/2010/041-190	Namibia	145,514.45	143,510.45	Residual Error of 1.38%
MED/2005/026-204	Morocco	30,000,000.00	30,000,000.00	No residual error.
ONG-PVD/2008/007-550	Armenia	421,364.70	421,364.70	No residual error.

7.2. Annex 2: Responses to anticipated challenges

Challenge[3]	Mitigating Action	Comments after testing of methodology
Residual Errors have evaded all prevention, detection and correction controls in the existing control framework. Any methodology for measuring RER must be capable of identifying errors which have not been identified elsewhere.	• Obtain a clear understanding of the potential limitations of the existing controls • Determine extent to which contract in question has been exposed to additional controls, and consider the effects (e.g. audit or ex-post control) • Focus on areas where existing controls have been established to suffer from weaknesses	• 'High Risk' transactions will usually have already been subject to detailed control procedures. Some substantive testing can permit an estimate of the reliability of those controls to be performed. • Use of RER audit personnel with extensive experience of auditing EU-funded expenditure enhances the possibility of detecting errors not identified by less experienced actors.
The methodology must focus upon transactions where there is no possibility of further correction of errors. In effect, this will entail examination of closed contracts. Many of the contracts closed during the period in question will relate to activities that took place many years ago. Conclusions about the effectiveness of the controls operating over the related expenditure (whether effective or not) may not be relevant and documentation may be difficult to locate.	• Reporting of results must enable the timing of the identified control failure to be identified, and contain sufficient information to enable a conclusion as to whether the control failure continues to exist.	• Refinement of methodology in respect of transactions where documentation cannot be provided. • Disclosure of potential consequences for RER measurement in respect of specific transactions where this is discovered to be the case.

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[3] Challenges identified in original Methodology Paper

Challenge[3]	Mitigating Action	Comments after testing of methodology
Error rates vary according to the characteristics of the transaction examined. DEVCO enters into transactions across a wide variety of geographical and thematic areas, employing numerous instruments for the execution of transactions.	• Use of standard audit programmes which are designed to cope with wide variety of instruments and thematic areas • Ensure adequate spread of contracts selected across geographic, thematic and instrumental areas. Introduce top-up samples where coverage is inadequate.	• The use of such programmes during the pilot study were specifically tailored to the contract types being tested. • Use of experienced personnel for RER audit work mitigates the risks associated with multiple transaction types.
A 'transaction' recorded on EuropeAid's accounting system can represent many thousands of further transactions at beneficiary level (e.g. for a Programme Estimate). It can also represent a very small number of 'sub-transactions' (e.g. a supply contract payment, or Budget Support payment).	• Allow for adequate time to examine complex transactions in detail; • Efficient identification of previous controls exercised on complex transactions (e.g. previous audits). • Prepare sample population at the most detailed level possible (i.e. at transaction level rather than contract level).	• In all cases examined, the financial reports were sufficiently detailed to allow scrutiny of sub-transactions. • Adequate provision should be made for the existence of some transactions in the sample which will take a very long time to examine in full.
The conditions governing legality and regularity of DEVCO expenditure are complex. Conclusions on the legality and regularity of a transaction (or aspects of it) can differ between individuals, particularly where there is any ambiguity in the legal framework governing a transaction.	• Use of standard 'audit programmes' for all substantive work • Use of a detailed typology of errors.	• The use of such programmes during the pilot study were specifically tailored to the contract types being tested. • Use of experienced personnel for RER audit work mitigates the risks associated with complex transactions.

Challenge[3]	Mitigating Action	Comments after testing of methodology
In order for the Residual Error Rate measurement relating to Year N to be considered by the Director General when signing his Declaration of Assurance, the result must be available by February of Year N+1. This means that fieldwork supporting the measurement would have to commence during Year N (i.e. before the complete population of closed contracts is known). Early commencement has an impact on the number of transactions that must be examined in order to produce a statistically reliable result.	• Sampling performed at intervals during the year • Interim substantive work commences shortly after conclusion of the previous year's exercise. • Error evaluation adjusted to ensure that different timing of sampling exercises is properly taken into account • Results of previous years' sampling can be taken into account when determining the effectiveness of controls in individual areas	• Efficient and detailed communication with Delegations is essential; • Prompt identification of previous control work is essential; • Prompt identification of transactions where on-the-spot work is necessary is essential.
The Director General is obliged to consider all ABBs separately when giving his Declaration of Assurance in the Annual Activity Report. The Commission has expressed an interest in the methodology proposed in this paper providing the necessary assurance for each ABB.	• Results of previous years' sampling can be taken into account when determining the effectiveness of controls in individual areas; • Commission will need to accept lower confidence levels in respect of individual ABB areas or other sub-groups (e.g. geographic areas, thematic areas).	• The transaction listings in CRIS allows separate reporting by ABB. • Reliable error rates in respect of individual ABBs would not be revealed by performance of one RER exercise alone.