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*Dear Convener,*

### European Structural and Investment Funds

I am writing in response to your letter on 9 September 2015 seeking further information about the European Commission's decision to suspend payments under the 2007-2013 European Structural and Investment Funds programming period. These suspensions apply to both the Highlands & Islands and Lowlands and Uplands (LUPS) European Social Fund Programmes and to the LUPS European Regional Development Fund Programme.

I share the Committee's concerns about the seriousness of the matter and hope to provide reassurance for the Committee about the steps being taken to reach an early resolution and progress on measures to avoid similar problems from arising in the 2014-2020 programmes.

### 2007-2013 suspensions

The Commission has stringent audit and control measures in place to ensure the use of European funds complies with EU legislation. The global economic downturn further emphasised the need to spend this funding wisely, and this, together with a recent increase in the number of fraud cases involving EU funds, has seen these processes tightened.

European Commission auditors have previously expressed concerns about the 2007-2013 programmes, notably that too many small and individual projects were supported and that this would inevitably lead to errors within projects.

These concerns were borne out when the 2013 Annual Control Report (ACR) reported errors in a number of projects at levels higher than the 2% "materiality" threshold, which the Commission sets as an acceptable level of error.

This triggered interruptions, and significant work was conducted between my officials and the organisations receiving funding to address the faults, ranging from failures to comply with procurement regulations to failures to trace receipts and invoices for European-funded activity.



At the time, the organisations involved provided assurances that the underlying problems would be addressed. However, many of the same organisations reported errors in the 2014 ACR. In 2014 18 organisations returned errors in excess of 5%.

In response to the 2014 ACR The Scottish Government worked closely with organisations and the European Commission, to address the errors raised on individual projects. These efforts led to individual error rates in a number of cases being reduced and, as a result, lower programme error rates of 3.30% for the Lowlands and Uplands and 2.56% for the Highlands and Islands.

The suspension of payments relates specifically to the 2007-2013 programmes – the European Social Fund and the European Regional Development Fund. Pending resolution of any underlying issues, the Commission is, in effect, withholding payments due as reimbursement to the Scottish Government for funding already paid to organisations' projects delivered during that programming period.

Our priority is to ensure that the work outlined here addresses any underlying issues and reassures the Commission, in order that the suspensions can be lifted as quickly as possible. However, the Committee will no doubt be aware that it is critical to the on-going use of Structural and Investment Funds in Scotland that the errors seen in the 2007-13 programmes are not repeated in the 2014-20 programmes. The 2014-2020 programmes are designed so that the audit burden and risks associated with the funds are better managed up-front.

### **Measures to minimise future risks**

In the 2014-20 programmes there are now a smaller number of key themes to ensure investments focus on key growth areas, and administration will be through the Scottish Government's Lead Partners - policy directorates, agencies and local authorities with increased administrative capacity and experience, and with the ability to provide match funding alongside EU funding.

My officials have also developed new risk-based assessment and approval, and compliance and verification processes for the 2014-2020 programmes and this is already being implemented, with a significant amount of project verification carried out in the early stages. Benefits of this approach include ensuring that costs proposed are eligible and that procurement is properly managed. Additional staff have been appointed to undertake the increased volume of work resulting from this and we aim to keep our partners and stakeholders fully informed of detailed programme and rule developments as the programmes roll out.

The technical work encompasses the development of a Management and Control System (MCS) to reflect the more robust arrangements for the new programmes. Significant work has taken place on the development of the MCS, with the Managing and Audit Authorities in Scottish Government working closely to ensure the risk-based approach addresses the issues and weaknesses identified in the 2007-2013 Programmes. For example, prior to an award of funding, projects will be risk-assessed on aspects such as procurement competence, experience of dealing with EU Funds, and risk management plans to guide the control measures which will then be applied throughout the project's lifetime.

The Scottish Government's Internal Audit Division as Audit Authority, have reviewed the Managing Authority Action Plan in relation to the suspensions and reported to the Commission that the proposals to address their concerns are adequate. The review concluded that the Managing Authority is actively implementing all of the measures outlined in the Action Plan and that this work addresses the Commission's concerns at an operational and strategic level.

## 2014-2020 approvals

While my officials continue to address the suspensions issue, the European Structural and Investment Funds programmes for 2014-2020 are progressing, with a number of European Social Fund and European Regional Development Fund allocations already approved. We recently announced £43 million to support organisations across Scotland for projects and programmes helping people furthest from the labour market to secure long-term employment, and £78 million to boost business innovation. We hope to shortly announce funding to support projects to reduce poverty and social exclusion.

I will keep the Committee fully informed of any further developments and look forward to providing updates on the activities taken forward under the 2014-2020 programmes.

Kind regards



**KEITH BROWN**

