

## IV

*(Notices)*NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND  
AGENCIES

## COURT OF AUDITORS



In accordance with the provisions of Article 287(1) and (4) of the TFEU and Articles 148(1) and 162(1) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 and Articles 139 and 156 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund

**the Court of Auditors of the European Union, at its meeting of 5 September 2013, adopted its**

**ANNUAL REPORTS**

**concerning the financial year 2012.**

The reports, together with the institutions' replies to the Court's observations, were transmitted to the authorities responsible for giving discharge and to the other institutions.

The Members of the Court of Auditors are:

Vítor Manuel da SILVA CALDEIRA (President), David BOSTOCK, Ioannis SARMAS, Igors LUDBORŽS, Jan KINŠT, Kersti KALJULAIID, Karel PINXTEN, Michel CRETIN, Harald NOACK, Henri GRETHEN, Szabolcs FAZAKAS, Louis GALEA, Ladislav BALKO, Augustyn KUBIK, Milan Martin CVIKL, Rasa BUDBERGYTĖ, Lazaros S. LAZAROU, Gijs DE VRIES, Harald WÖGERBAUER, Hans Gustaf WESSBERG, Henrik OTBO, Pietro RUSSO, Ville ITÄLÄ, Kevin CARDIFF, Baudilio TOMÉ MUGURUZA, Iliana IVANOVA, George PUFAN, Neven MATES.



# **ANNUAL REPORT ON THE IMPLEMENTATION OF THE BUDGET**

(2013/C 331/01)



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## GENERAL INTRODUCTION

0.1. The European Court of Auditors is the institution established by the Treaty to carry out the audit of European Union (EU) finances. As the EU's external auditor it acts as the independent guardian of the financial interests of the citizens of the Union and contributes to improving EU financial management. More information on the Court can be found in its annual activity report which, together with its special reports on EU spending programmes and revenue and its opinions on new or amended legislation, are available on its website:

[www.eca.europa.eu](http://www.eca.europa.eu)

0.2. This is the Court's 36th annual report on the implementation of the EU budget and covers the 2012 financial year. A separate annual report covers the European Development Funds.

0.3. The general budget of the EU is decided annually by the Council and the European Parliament. The Court's annual report, together with its special reports, provides a basis for the discharge procedure, in which the European Parliament decides whether the Commission has satisfactorily carried out its responsibilities for implementing the budget. The Court forwards its annual report to national parliaments at the same time as to the European Parliament and the Council.

0.4. The central part of the annual report is the Court's statement of assurance (the 'DAS') on the reliability of the consolidated accounts of the EU and on the legality and regularity of transactions (referred to in the report as 'regularity of transactions'). The statement of assurance itself begins the report; the material which follows reports mainly on the audit work underlying the statement of assurance.

0.5. The report is organised as follows:

- chapter 1 contains the statement of assurance and a summary of the results of the Court's audit on the reliability of accounts and on the regularity of transactions, a section on recoveries and financial corrections, as well as a summary report on the management of the budget in 2012. Annex 1.3 in chapter 1 provides extracts from the 2012 consolidated accounts. More extensive 2012 financial

information is presented in the published consolidated accounts and in the financial report prepared by the European Commission, both available on:

[http://ec.europa.eu/budget/biblio/documents/2012/2012\\_en.cfm](http://ec.europa.eu/budget/biblio/documents/2012/2012_en.cfm)

- chapters 2 to 9 provide detailed audit findings in the form of 'specific assessments' of EU revenue and expenditure. Chapter 2 deals with the revenue side of the EU budget; chapters 3 to 9 with seven groups of policy areas within which spending from the EU budget is authorised and recorded. These groups of policy areas correspond broadly to the headings used in the 2007-2013 financial framework, which sets out the EU's broad multiannual spending plans;
- chapter 10 analyses performance measurement in the management plans and annual activity reports of three of the Commission's directors-general, identifies common themes in the special reports which the Court has adopted in 2012 and covers briefly the Commission's second and third evaluation reports.

0.6. The specific assessments are mainly based on the results of the Court's testing of the regularity of transactions and on an assessment of the effectiveness of the principal supervisory and control systems governing the revenue or expenditure involved.

0.7. Within the specific assessments the definition of underlying transactions has been harmonised. This harmonisation affects in particular chapters 7 and 8 of the annual report (see paragraphs 7.13 to 7.15 and 8.13). A description of the changes and their impact is detailed in chapter 1 (see paragraphs 1.6, 1.7, 1.15 and graph 1.1).

0.8. The Commission's replies (or replies of other EU institutions and bodies, where appropriate) to the Court's observations are presented within the document. The Court's description of its findings and conclusions takes into account the relevant replies of the auditee. However it is the Court's responsibility, as external auditor, to report its audit findings, to draw conclusions from those findings, and thus to provide an independent and impartial assessment of the reliability of the accounts as well as of the regularity of transactions.





## CHAPTER 1

**The Statement of Assurance and supporting information**

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## THE COURT'S STATEMENT OF ASSURANCE PROVIDED TO THE EUROPEAN PARLIAMENT AND THE COUNCIL — INDEPENDENT AUDITOR'S REPORT

I. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU) the Court has audited:

- (a) the consolidated accounts of the European Union which comprise the consolidated financial statements <sup>(1)</sup> and the aggregated reports on the implementation of the budget <sup>(2)</sup> for the financial year ended 31 December 2012, approved by the Commission on 26 July 2013; and
- (b) the legality and regularity of the transactions underlying those accounts.

### *Management's responsibility*

II. In accordance with Articles 310 to 325 of the TFEU and the Financial Regulation, management is responsible for the preparation and presentation of the consolidated accounts of the European Union on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. The Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the European Union (Article 317 of the TFEU).

### *Auditor's responsibility*

III. The Court's responsibility is to provide, on the basis of its audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the transactions underlying them. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that the Court plans and performs the audit to obtain reasonable assurance as to whether the consolidated accounts of the European Union are free from material misstatement and the transactions underlying them are legal and regular.

IV. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgement, including an assessment of the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the European Union, whether due to fraud or error. In making those risk assessments, internal control relevant to the preparation and fair presentation of the consolidated accounts and legality and regularity of underlying transactions, is considered in order to design audit procedures that are appropriate in the circumstances but not for the purposes of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the consolidated accounts.

V. For revenue, the Court's examination of value added tax and gross national income-based own resources takes as its starting point the relevant macroeconomic aggregates on which these are calculated, and assesses the Commission's systems for processing these until the contributions of the Member States have been received and recorded in the consolidated accounts. For traditional own resources, the Court examines the accounts of the customs authorities and analyses the flow of duties until the amounts are received by the Commission and recorded in the accounts.

<sup>(1)</sup> The consolidated financial statements comprise the balance sheet, the statement of financial performance, the cashflow statement, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes (including segment reporting).

<sup>(2)</sup> The aggregated reports on implementation of the budget comprise the aggregated reports on implementation of the budget and explanatory notes.

VI. For expenditure, the Court examines payment transactions when expenditure has been incurred, recorded and accepted ('expensed payments'). This examination covers all categories of payments (including those made for the purchase of assets) other than advances at the point they are made. Advance payments are examined when the recipient of funds provides justification for their proper use and the Institution or body accepts the justification by clearing the advance payment, whether in the same year or later.

VII. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its opinions.

## Reliability of the accounts

### *Opinion on the reliability of the accounts*

VIII. In the Court's opinion, the consolidated accounts of the European Union for the year ended 31 December 2012 present fairly, in all material respects, the financial position of the Union as at 31 December 2012, the results of its operations, its cash flows, and the changes in net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

## Legality and regularity of the transactions underlying the accounts

### Revenue

#### *Opinion on the legality and regularity of revenue underlying the accounts*

IX. In the Court's opinion, revenue underlying the accounts for the year ended 31 December 2012 is legal and regular in all material respects.

### Commitments

#### *Opinion on the legality and regularity of commitments underlying the accounts*

X. In the Court's opinion, commitments underlying the accounts for the year ended 31 December 2012 are legal and regular in all material respects.

### Payments

#### *Basis for adverse opinion on the legality and regularity of payments underlying the accounts*

XI. The Court concludes that the supervisory and control systems examined are partially effective in ensuring the legality and regularity of payments underlying the accounts (paragraph VI). All policy groups covering operational expenditure are materially affected by error. The Court's estimate for the most likely error rate for expensed payments underlying the accounts is 4,8 % <sup>(3)</sup>.

<sup>(3)</sup> On the basis of the sampling approach used in previous years the estimated most likely error would have been 4,5 %.

*Adverse opinion on the legality and regularity of payments underlying the accounts*

XII. In the Court's opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2012 are materially affected by error.

5 September 2013

Vítor Manuel da SILVA CALDEIRA

*President*

European Court of Auditors

12, rue Alcide De Gasperi, 1615 Luxembourg, LUXEMBOURG

## THE COURT'S OBSERVATIONS

**INTRODUCTION**

1.1. This chapter of the annual report:

- sets out the background to the Court's Statement of Assurance and summarises and analyses the audit findings and conclusions which underlie this statement,
- explains how the Court carries out its audit of regularity and of the reliability of the accounts (see **Annex 1.1**), and
- presents the actions taken by the Commission in response to the Court's observations and recommendations in previous annual reports on the reliability of the accounts (see **Annex 1.2**).

1.2. The Court of Auditors provides the European Parliament and the Council with a Statement of Assurance concerning the reliability of the accounts and the regularity of the underlying transactions. The Court supplements this statement with specific assessments of each major area of EU activity<sup>(4)</sup>. The role of these specific assessments is not equivalent to an audit opinion; they have the primary function of presenting significant issues specific to the policy groups to the discharge authorities and other stakeholders. The conclusion of each specific assessment is based on the overall audit evidence gathered at the level of the policy group.

1.3. The aim of the work on the reliability of the accounts of the European Union is to obtain sufficient appropriate evidence to conclude on the extent to which revenue, expenditure, assets and liabilities have been properly recorded and that the consolidated accounts (see extract in **Annex 1.3**) properly present the financial position at 31 December 2012, and the revenues, expenses and cashflows for the year then ended (see paragraphs 1.9 and 1.10).

1.4. The aim of the work on the regularity of the transactions underlying the 2012 consolidated accounts is to obtain sufficient appropriate evidence to conclude on whether those transactions are in accordance with the applicable regulations or contractual provisions, and have been correctly calculated (see paragraphs 1.11 to 1.35 for an overview of the results and chapters 2 to 9 for more details).

<sup>(4)</sup> See Article 287 TFEU.

## THE COURT'S OBSERVATIONS

1.5. The aim of the examination of the annual activity reports of the Commission's services and of the related synthesis report is to assess the extent to which they provide a fair assessment of the quality of financial management (including residual levels of error), and thus help form a view of the reliability of the EU accounts and the regularity of revenue and expenditure (see paragraphs 1.36 to 1.45 and related observations in the sections 'Effectiveness of systems' in chapters 2 to 9).

**DEVELOPMENT OF THE COURT'S SAMPLING APPROACH**

1.6. The approach to the examination of the regularity of transactions has been updated and harmonised. The Court's sample of transactions now includes only interim payments, final payments and clearing of advances ('expensed payments'). Transactions in the policy groups 'External relations, aid and enlargement' (chapter 7) and 'Research and other internal policies' (chapter 8) are now, as was already the case in all other policy groups, examined at a point when the final recipients of EU funds have undertaken activities or incurred costs, and when the Commission has accepted that the activities undertaken or costs incurred justified payment from the EU budget. This is in accordance with the treaty obligation on the Court to check expenditure once it has been 'incurred'. Notwithstanding this change, all payments except advances are subject to audit in the year that they are made. This includes payments which are used to purchase assets (and therefore represent budgetary expenditure but not an accruals expense). The impact of this development is discussed in paragraphs 1.14 and 1.15 and **Graph 1.1**.

1.7. This sampling approach is consistent with the principles underlying accruals accounting<sup>(5)</sup>. A further advantage of this development is that all areas of shared and non-shared management are now examined on a comparable basis. In addition, audited populations will be more stable from year to year as the impact of fluctuating levels of advances will be eliminated. Advances continue to be covered both through the examination of the regularity of clearing of advances and work on the reliability of the accounts.

## THE COMMISSION'S REPLIES

**1.6.** The Commission notes that the Court's new approach leads to an amended definition of the audited population. While the Commission recognises the advantages of the Court's new approach, it notes that the audited population is no longer limited to types of transactions underlying the budgetary accounts. Instead new transactions are included from the general accounts based on concepts which require a certain accounting expertise.

The Commission considers that this new interpretation by the Court has considerable implications (see replies to paragraphs 1.7, 1.12, 1.14 and 1.19 to 1.35). Therefore, it is very important that clear explanations, methods and terms are used which allow stakeholders to understand changes made and to assess the resulting impacts.

**1.7.** The Commission appreciates the inclusion of the clearing of advances paid in previous years in the audit scope. It considers that this opens the way to greater consideration of the impact of multi-annual corrective mechanisms. Article 32 of the Financial Regulation defines internal control as a 'process applicable at all levels of management and designed to provide reasonable assurance of achieving the following objectives: ... (d) prevention, detection, correction and follow-up of fraud and irregularities'.

The Commission is closely following the developments of the Court's methodology in view of any potential impact on the estimated error rate (see reply to paragraphs 3.9 and 4.8).

<sup>(5)</sup> The Commission has been preparing accounts on an accruals basis since 2005 and the Court has been assessing them as reliable since 2007.

## THE COURT'S OBSERVATIONS

**PROCUREMENT**

1.8. The Court has also, after extensive consultation with the budgetary authorities, harmonised its approach to the treatment of procurement errors. Previously serious errors were treated as quantifiable errors when the error was committed by Member State authorities or international organisations. The Court recorded all errors committed by the EU Institutions and bodies as 'non-quantifiable' and thus excluded them from the estimated error rate. Beginning in 2012, serious procurement errors by all bodies are treated as quantifiable. However, the Court has not backdated its approach to cover procurement activities by the EU Institutions and bodies which took place before 2011 <sup>(6)</sup>.

**AUDIT FINDINGS FOR THE 2011 FINANCIAL YEAR****Reliability of accounts**

1.9. The Court's observations concern the consolidated accounts of the European Union for the financial year 2012 prepared by the Commission's accounting officer and approved by the Commission in compliance with the Financial Regulation <sup>(7)</sup> and received, together with the accounting officer's letter of representation, by the Court on 29 July 2013. The consolidated accounts comprise:

- (a) the consolidated financial statements covering the balance sheet (presenting the assets and liabilities at the end of the year), the statement of financial performance (recognising the income and expenses of the year), the cashflow statement (disclosing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets as well as the related notes;
- (b) the aggregated reports on the implementation of the budget covering the revenue and expenditure for the year as well as the related notes.

1.10. The Court's audit of the 2012 consolidated accounts found that these were free from material misstatements (see also **Annex 1.2**).

<sup>(6)</sup> A small number of errors were noted in procurement for operational expenditure activities from 2010 and earlier which gave rise to payments in 2012; these are not extrapolated nor included in the overall estimated error rate.

<sup>(7)</sup> Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union (OJ L 298, 26.10.2012, p. 1) requires that the final accounts shall be sent by 31 July of the following financial year (see Article 148).

## THE COURT'S OBSERVATIONS

### Summary of specific assessments and audit results supporting the Statement of Assurance

1.11. The Court provides specific assessments on revenue in chapter 2 and on expenditure in chapters 3 to 9 (see *Table 1.1*).

**Table 1.1 — Transactions subject to audit for annual report chapters 3 to 9**

(million euro)

Annual report chapter		Payments made in 2012 <sup>(2)</sup>	Transactions subject to audit in 2012
		(A)	(B)
Chapter 3	Agriculture: market and direct support	44 545	44 546
Chapter 4	Rural development, environment, fisheries and health	14 778	14 994
Chapter 5	Regional policy, energy and transport	39 853	40 735
Chapter 6	Employment and social affairs	11 606	13 404
Chapter 7	External relations, aid and enlargement	6 109	6 616
Chapter 8	Research and other internal policies	11 740	10 667
Chapter 9	Administrative and other expenditure <sup>(1)</sup> <sup>(2)</sup>	10 052	9 985
Grand Total		138 683	140 947

'Transactions subject to audit in 2012' (B) consist of 'Payments made in 2012' (A) excluding advance payments made in 2012 (14 519 million euro) and including clearing of advances in 2012 (16 783 million euro).

<sup>(1)</sup> This chapter also covers expenditure considered in the general budget as operational although its purpose is in most cases the functioning of the Commission's administration rather than policy delivery.

<sup>(2)</sup> Administrative expenditure for various policy groups amounts (in million euro) to:

- chapter 3: 133
- chapter 4: 253
- chapter 5: 229
- chapter 6: 93
- chapter 7: 624
- chapter 8: 1 627.



## THE COURT'S OBSERVATIONS

1.12. The 2012 audit results indicate that revenue (139 541 million euro) and transactions in the policy group administrative and other expenditure (9 985 million euro) were free from material error and that the examined supervisory and control systems were effective (see **Table 1.2** and paragraphs 2.40 to 2.42 and 9.17). All policy groups covering operational expenditure were affected by material error (see paragraphs 3.35, 4.42, 5.62 to 5.63, 6.39 to 6.40, 7.25 to 7.26 and 8.39 to 8.40). Commitments were free from material error.

## THE COMMISSION'S REPLIES

**1.12.** The Commission is bound by the Financial Regulation which stipulates, in Article 32(2)(e), that its internal control system should ensure, amongst other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions taking into account the multiannual character of programmes and the nature of payments'.

The Commission will continue to exercise its supervisory role, in particular by implementing financial corrections and recoveries at a level that corresponds to the level of irregularities and deficiencies identified. Due to the legal framework for protecting the Union financial interests and the complexity of the related procedures, it is unavoidable that in many areas errors are only corrected several years after they have occurred. Therefore, the Commission considers that the Court's annual representative error rate should be seen in this context. This is why the Commission itself generally uses the residual error rate, which takes account of financial corrections and recoveries over the multiannual implementation period including some for future years. In addition, in assessing the level of estimated error in 2012, the Commission takes into account the impact of flat-rate corrections within the year, which are excluded from the Court's estimation of the error rate.

The Commission considers that the residual error rate gives a fair indication of the extent to which the EU budget remains affected by expenditure incurred in breach of law after the operation of supervisory and control systems.

Table 1.2 — 2012 Summary of findings on regularity of transactions

Annual report chapter	Transactions subject to audit (million euro)	Assessment of supervisory and control systems examined <sup>(1)</sup>	Most likely error (MLE) 2012 (%)	Confidence interval (%)		Frequency of errors <sup>(2)</sup> (%)	Audit conclusions	Most likely error (MLE) 2011 (%) for comparison <sup>(3)</sup>
				Lower error limit (LEL)	Upper error limit (UEL)			
Agriculture: market and direct support	44 546	Partially effective	<b>3,8</b>	1,7	5,9	41	Affected by material error	<b>2,9</b>
Rural development, environment, fisheries and health	14 994	Partially effective	<b>7,9</b>	4,5	11,3	63	Affected by material error	<b>7,7</b>
Regional policy, energy and transport	40 735	Partially effective	<b>6,8</b>	3,7	9,9	49	Affected by material error	<b>6,0</b>
Employment and social affairs	13 404	Partially effective	<b>3,2</b>	1,3	5,1	35	Affected by material error	<b>2,2</b>
External relations, aid and enlargement	6 616	Partially effective	<b>3,3</b> <sup>(3)</sup>	1,4	5,2	23	Affected by material error	<b>1,1</b> <sup>(3)</sup>
Research and other internal policies	10 667	Partially effective	<b>3,9</b> <sup>(4)</sup>	1,8	6,0	49	Affected by material error	<b>3,0</b> <sup>(4)</sup>
Administrative and other expenditure	9 985	Effective	<b>0</b>	—	—	1	Free from material error	<b>0,1</b>
<b>Total, expensed payments</b>	<b>140 947</b>	Partially effective	<b>4,8</b> <sup>(5)</sup>	3,6	6,0	38	<b>Affected by material error</b>	<b>3,9</b> <sup>(5)</sup>
<b>Revenue</b>	<b>139 541</b> <sup>(6)</sup>	Effective	<b>0</b>	—	—	0	<b>Free from material error</b>	<b>0,8</b>

<sup>(1)</sup> The classification of systems is explained in **Annex 1.1**. For the specific assessment of the systems examined see paragraphs 2.40 to 2.42, 3.9 and 3.35, 7.25 and 8.39. The Court's summary assessments for 2012 are consistent with those for 2011.

<sup>(2)</sup> The frequency of errors represents the proportion of the sample affected by quantifiable and non-quantifiable errors. Percentages are rounded.

<sup>(3)</sup> The estimated error rate for 'External relations, aid and enlargement' is higher than the error rate estimated in 2011 (1,1 %). This difference should be interpreted in the light of the development of the Court's sampling approach (see paragraphs 1.6 and 1.7). This change in approach is the principal identifiable reason for the increase in the estimated error rate (see paragraphs 1.15 and 7.13 to 7.15).

<sup>(4)</sup> The estimated error rate for 'Research and other internal policies' is higher than the error rate estimated in 2011 (3,0 %). This difference should be interpreted in the light of the development of the Court's sampling approach (see paragraphs 1.6 and 1.7). This change in approach is the principal identifiable reason for the increase in the estimated error rate (see paragraphs 1.15 and 8.13 to 8.15).

<sup>(5)</sup> The developments in the Court's sampling approach explained in paragraphs 1.6 and 1.7 represents at most 0,3 percentage points of the most likely error for 2012 (see paragraph 1.13 and **Graph 1.1**).

<sup>(6)</sup> The audit involved examination at the Commission level of a sample of recovery orders covering all types of revenue (see paragraph 2.9).

## THE COURT'S OBSERVATIONS

1.13. The Court concludes that, overall, expensed payments were materially affected by error and that the supervisory and control systems examined for expensed payments were, in general, partially effective (see **Table 1.2**).

## THE COMMISSION'S REPLIES

**1.13.** The Commission recognises that the systems are partially effective as reflected in the Court's estimated error rate at the level of final recipients. As a consequence of the operation of its supervisory and control systems, the Commission has implemented financial corrections and recoveries in 2012 amounting to 4 419 million euro which corresponds to the equivalent of 3,2 % as compared to the payments made (see table 1.1). For a breakdown of the figures per policy area see below:

- Chapter 3 — Agriculture — Market and Direct Support: 771 million euro of financial corrections and recoveries (1,7 % of the payments made),
- Chapter 4 — Rural development, Environment, Fisheries and Health: 258 million euro of financial corrections and recoveries (1,7 % of the payments made),
- Chapter 5 — Regional policy, Energy and Transport: 2 719 million euro of financial corrections and recoveries (6,8 % of the payments made),
- Chapter 6 — Employment and Social Affairs: 442 million euro of financial corrections and recoveries (3,8 % of the payments made),
- Chapter 7 — External relations, Aid and Enlargement: 99 million euro of financial corrections and recoveries (1,6 % of the payments made),
- Chapter 8 — Research and Other Internal Policies: 120 million euro of financial corrections and recoveries (1 % of the payments made), and
- Chapter 9 — Administrative expenditure: 9 million euro of financial corrections and recoveries (N/A of the payments made).

This does not mean that all recoveries and financial corrections implemented in year T can be deducted from the errors of year T. However, it implies that when assessing whether the overall system of internal control is effective in protecting the EU budget on a multi-annual basis, both error rates and recoveries/financial corrections have to be taken into account.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Analysis of audit results**

1.14. This year's results again show an increase in overall estimated error rates. The most likely error for payments taken as a whole has increased from 3,9 % to 4,8 %. All areas of operational expenditure contributed to this increase with 'Rural development, environment, fisheries and health' (chapter 4) remaining the most error-prone policy group.

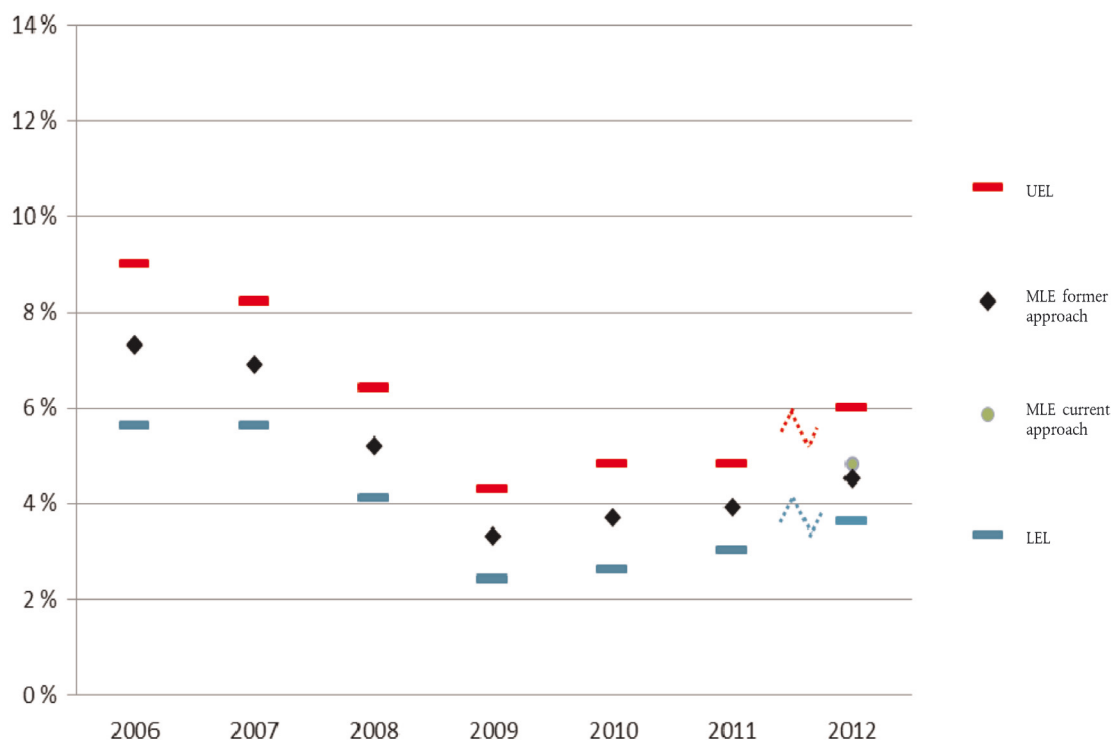
1.15. The change in the most likely error rate attributable to the development in the Court's sampling approach (see paragraphs 1.6 and 1.7) does not exceed 0,3 percentage points. This change in approach is the principal identifiable reason for the increase in the estimated error rate for chapters 7 ('External relations, aid and enlargement') and 8 ('Research and other internal policies').

**1.14.** For practically all transactions in the various audit samples the assessment of the Commission is close to the Court's conclusion. The Commission notes however that the flat-rate financial corrections implemented at programme level within the financial year are not taken into account by the Court when calculating its error rate (see box 1.2 and paragraph 6.39(a)) — See also paragraphs 5.26, 5.33 and 5.62).

The Commission therefore estimates the overall level of error of transactions underlying the EU consolidated accounts to be broadly in line with the error rates presented by the Court for the three last years. This derives from the reinforced control provisions of the 2007-2013 programming period and its strict policy of interruptions/suspensions/financial corrections/recoveries when deficiencies are identified.

**1.15.** See reply to paragraphs 1.6 and 1.7.

**Graph 1.1 — The Court's estimate of the most likely error (2006-2012) <sup>(1)</sup>**



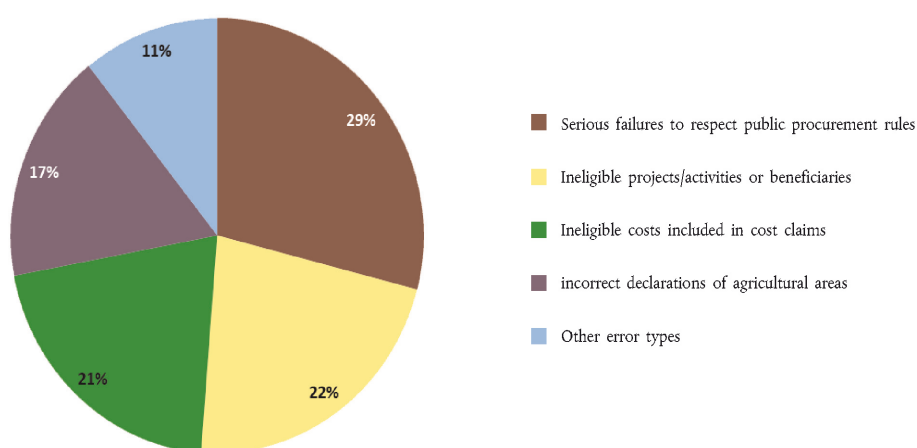
<sup>(1)</sup> The two points for 2012 represent the error rate (MLE) estimated by the Court in 2012 (4,8 %, see **Table 1.2**) and an estimate of what would have been the MLE had the same findings been detected in a sample drawn on the same basis as in previous years (4,5 %, see paragraphs 1.14 and 1.15). The upper and lower error limits (UEL and LEL) for 2012 are based on the sampling approach for 2012 (current approach).

## THE COURT'S OBSERVATIONS

1.16. The Court calculates that the estimated rate of error taken as a whole on shared management expenditure amounts to 5,3 % and on all other forms of operational expenditure <sup>(8)</sup> to 4,3 %.

1.17. Analysing the types of error across the different policy groups shows that eligibility errors account for more than two thirds of the overall estimated error rate: serious failures to respect public procurement rules (1,4 percentage points), wholly ineligible projects/activities or beneficiaries (1,1 percentage points), ineligible costs included in cost claims (1,0 percentage points) and incorrect declarations in agricultural area (0,8 percentage points) (see **Graph 1.2**).

**Graph 1.2 — Contribution to overall estimated error by type**



1.18. A breakdown of the overall estimated error rate by chapter shows that 'Regional policy, energy and transport' (chapter 5) contributes more than two fifths of the overall estimated error rate, 'Agriculture: market and direct support' (chapter 3) contributes a quarter and 'Rural development, environment, fisheries and health' (chapter 4) contributes more than a sixth (see **Graph 1.3**).

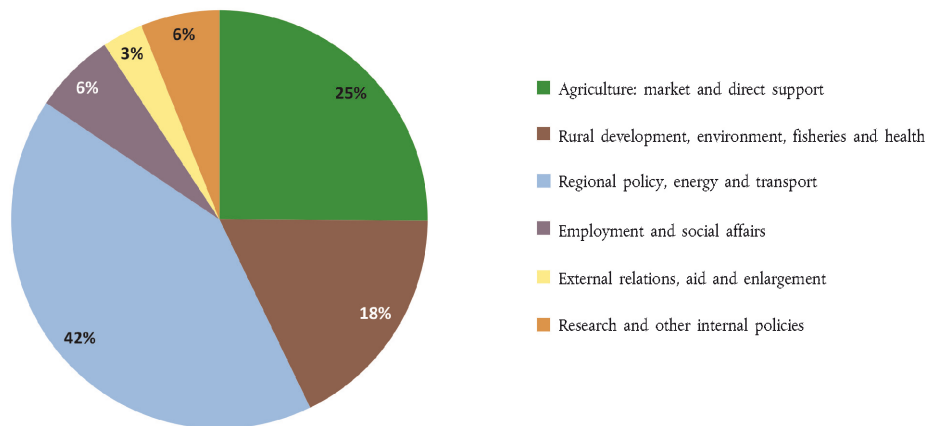
## THE COMMISSION'S REPLIES

**1.16.** The Commission notes that the Court's estimated error rate on administrative expenditure managed directly by the European Institutions (10 billion euro in 2012) is 0 % (see chapter 9, paragraph 9.8).

**1.17.** The Commission has made, in the context of shared management, considerable efforts to ensure strict compliance with eligibility requirements and the correct application of public procurement rules. These include both preventive actions, such as a strict policy on interruptions and suspension of payments, and corrective actions, such as financial corrections (for cohesion policy see paragraph 5.33, second and third indents).

**1.18.** See replies to paragraph 1.14.

<sup>(8)</sup> Mainly represented by chapters 7 and 8, but also covering parts of the expenditure covered by chapters 4 and 5. The extrapolated error for shared management expenditure is based upon the examination of 685 transactions (drawn from a population of 110,8 billion euro), the extrapolation for other forms of operational expenditure is based upon the examination of 356 transactions (drawn from a population of 20,1 billion euro).

**Graph 1.3 — Contribution to overall estimated error by chapter**

## THE COURT'S OBSERVATIONS

**Taking account of recoveries and financial corrections**

1.19. Financial corrections reported as implemented <sup>(9)</sup> in 2012 amounted to 3,7 billion euro, more than three times the figure for 2011 (1,1 billion euro). Recoveries remained essentially constant at 678 million euro (2011: 733 million euro) <sup>(10)</sup>. Most corrections in 2012 refer to the 2000-2006 programme period. This section of the annual report deals with mechanisms for making financial corrections and recoveries and the Court's consideration of the impact of recoveries and financial corrections. The Court keeps the impact of financial corrections under continuous review <sup>(11)</sup>. The approach followed in 2012 is consistent with that set out in 2009.

## THE COMMISSION'S REPLIES

**1.19 to 1.35.** *The Commission appreciates the inclusion of clearing of advances paid in previous years in the new sampling approach. It considers that this opens the way to greater consideration of the impact of the multiannual corrective mechanisms referred to in the Articles 59 and 80 of the Financial Regulation (see paragraphs 1.22 and 1.24).*

*The Commission will continue to exercise its supervisory role, in particular by implementing financial corrections and recoveries at a level that corresponds to the level of irregularities and deficiencies identified. Due to the legal framework for protecting the Union financial interests and the complexity of the related procedures, in many areas it is unavoidable that errors are only corrected several years after they have occurred. Therefore, the Commission considers that the Court's annual representative error rate should be seen in this context.*

<sup>(9)</sup> Implementation is the final stage in the financial correction process. See also the Court's 2009 annual report, paragraph 1.42.

<sup>(10)</sup> As presented in Note 6.4.2.2 of the consolidated accounts 2012 and Note 6.2 of the consolidated accounts 2011 respectively.

<sup>(11)</sup> See the Court's 2009 annual report, paragraphs 1.32 to 1.50.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**The complex mechanisms for making financial corrections and recoveries**

1.20. The Commission and the Member States are able to employ several mechanisms to reduce the risk of error before expenditure reported by beneficiaries is accepted by the Commission. These mechanisms include the approval of control systems; administrative checks on claims for payments; on site visits (such as farm inspections); certification of eligible costs by an independent body; interruption or suspension of payments to Member States.

1.21. Once payments are made, and the use of funds has been accepted, both Commission and Member States may make *ex post* checks of the operation of control systems and of declared expenditure. These can have financial consequences in two ways: recoveries from beneficiaries; and the application of financial corrections to Member State authorities.

*What are recoveries?*

1.22. Recovery action is taken both by authorities in the Member States (for expenditure covered by shared management) and by the Commission (notably in areas where it is solely responsible for managing expenditure such as research and a large part of external spending). Recovery means the beneficiary repays all or part of the funds it received to the body which made the initial payment. In most areas of the budget, these funds become available for payment to other beneficiaries <sup>(12)</sup>.

**1.21.** Financial corrections do not relieve the Member States from the obligation to recover the undue payments from the beneficiaries whenever it is feasible and cost-effective.

*In addition to the financial consequences mentioned by the Court, in some policy areas, Member States can also implement a correction by withdrawing the ineligible expenditure from a subsequent payment request and re-using the funds thus released for other eligible projects. In such cases recovering the corrected amounts from beneficiaries becomes a national issue, since the EU budget is protected and no longer concerned by the irregular amounts.*

**1.22.** According to the Financial Regulation, in particular for shared management, responsibility for recoveries lies with the Member States:

- Article 59(2): ‘... In order to protect the Union's financial interests, Member States shall, respecting the principle of proportionality, and in compliance with this Article, and the relevant sector-specific rules, carry out *ex ante* and *ex post* controls including, where appropriate, on-the-spot checks on representative and/or risk-based samples of transactions. They shall also recover funds unduly paid and bring legal proceedings where necessary in this regard.’
- Article 80(3): ‘Member States shall in the first instance be responsible for carrying out controls and audits and for recovering amounts unduly spent, as provided for in the sector-specific rules. To the extent that Member States detect and correct irregularities on their own account, they shall be exempt from financial corrections by the Commission concerning those irregularities.’

<sup>(12)</sup> A notable exception is the European Agricultural Guarantee Fund (EAGF) spending.

## THE COURT'S OBSERVATIONS

*What are financial corrections and how do they work?*

1.23. For shared management expenditure the Commission can initiate financial corrections where there are serious deficiencies or when the Member State has failed to properly exercise its responsibilities to detect and correct irregular expenditure.

1.24. The problems dealt with often involve weaknesses in control systems, or a failure to comply with EU rules for the management of a programme which has been shown to have a financial impact (i.e. allows ineligible expenditure to be made). The amount of a financial correction may be calculated on the basis of individual cases examined, on the basis of an extrapolation of test results or, when it is not possible to use one of these two methods, through the application of flat-rate correction.

*What is the impact of financial corrections on the Member State?*

1.25. The impact of financial corrections on Member States depends <sup>(13)</sup> on the regulatory arrangements applicable:

## THE COMMISSION'S REPLIES

**1.25.** The Commission notes that the Court does not ask what the impact of the financial corrections is on the EU budget.

Article 80(4) of the Financial Regulation states:

*The Commission shall make financial corrections on Member States in order to exclude from Union financing expenditure incurred in breach of applicable law. The Commission shall base its financial corrections on the identification of amounts unduly spent, and the financial implications for the budget. Where such amounts cannot be identified precisely, the Commission may apply extrapolated or flat-rate corrections in accordance with the sector-specific rules.*

*The Commission shall, when deciding on the amount of a financial correction, take account of the nature and gravity of the breach of applicable law and the financial implications for the budget, including the case of deficiencies in management and control systems ...'*

*The aim of financial corrections is not to punish Member States, but to ensure that the budget is protected (i.e. that all expenditure charged to the EU budget is regular), by excluding expenditure incurred in breach of law.*

<sup>(13)</sup> See paragraph 1.34 of the Court's 2009 annual report.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(a) In the case of agriculture, conformity decisions lead to financial corrections (paragraph 4.26(b)), which are executed by reducing funding for the Member State concerned <sup>(14)</sup>.

(b) In the case of cohesion policy, the impact of financial corrections depends on whether the Member State accepts the correction proposed by the Commission or not <sup>(15)</sup>:

(i) when the Member State accepts the correction, it withdraws either expenditure declared relating to a group of projects found to be affected by error, a specific element of the expenditure declared, an amount calculated based on an extrapolation of test results or an amount corresponding to the flat-rate correction. In this case these funds can be reused to finance other eligible operations;

(ii) when a Member State does not accept the financial correction proposed, the Commission may take a formal decision itself to apply a financial correction. A financial correction applied by Commission decision involves a net reduction of EU funding to the programme and Member State concerned. Approximately 1 %, i.e. 32 million euro of the financial corrections implemented in 2012 relate to such Commission decisions.

(b) *The Commission notes that the impact of financial corrections is always negative at Member State's level.*

(i) *Where the financial correction is accepted by the Member State itself, the Member State must replace ineligible expenditure by eligible operations, in order not to lose EU funds.*

(ii) *When the financial correction is imposed by the Commission, the correction is net and there is a financial loss of the EU contribution.*

*In both cases (paragraphs 1.25(b)(i) and (ii)), the Member State bears with their own national budget the financial consequences of the loss of EU co-financing of the expenditure considered ineligible, unless it has the possibility to recover the amounts from individual beneficiaries.*

<sup>(14)</sup> Financial corrections in agriculture are recorded as assigned revenue and are therefore not lost to the budget title for 'Agriculture and rural development'.

<sup>(15)</sup> See section 2 of the Accounting Officer's 'Quarterly reports regarding provisional figures for 2012 for financial corrections under the Cohesion policy 2012' at 31 March, 30 June, 30 September 2012 respectively, as included in the discharge 2011 documents of the Committee on Budgetary Control of the European Parliament under the heading 'Financial corrections – Cohesion policy' (<http://www.europarl.europa.eu/committees/en/cont/publications.html?id=CONT00004#menuzone>).

## THE COURT'S OBSERVATIONS

*What is the impact of financial corrections on the beneficiary?*

1.26. In the case of agriculture, Member States are required to recover irregular expenditure<sup>(16)</sup>; but financial corrections imposed by the Commission rarely require farmers and other beneficiaries to repay<sup>(17)</sup>.

1.27. In cohesion policy, Member State authorities are required to make financial corrections in connection with the irregularities detected in projects<sup>(18)</sup>. As discussed below, there is great variation in the extent to which recoveries are made from beneficiaries (see boxes 1.2 and 1.3).

1.28. Any recovery made by Member States at the time of the Court's audit is taken into account and the amounts in question are no longer included in the error calculation.

## THE COMMISSION'S REPLIES

**1.26.** The Commission notes that even if the Member States do not recover the expenditure from the final beneficiary, the financial correction at the level of the Member State means that the EU budget is protected. The expenditure is no longer funded by the EU budget but by the national budget.

**1.27.** The regulatory framework leaves the choice to the Member States to immediately deduct amounts considered irregular from the next payment claim, even before recovery at national level (about 83 % of the total), or to wait for the effective recovery from beneficiaries to deduct this amount from a subsequent payment claim (about 17 % of the total).

<sup>(16)</sup> Article 9(1)(a) of Council Regulation (EC) No 1290/2005 (OJ L 209, 11.8.2005, p. 1): 'Member States shall (a) ... (iii) recover sums lost as a result of irregularities or negligence'.

<sup>(17)</sup> The amounts of recoveries in EAGF (2012: 162 million euro, Note 6.4.2.1 of the consolidated accounts 2012) include amounts recovered from farmers and other beneficiaries of funds based upon action taken by paying agencies which reflect recoveries stemming both from Commission conformity decisions and from paying agencies' own work. In addition recoveries recorded include the application of the fifty-fifty rule where the cost of non-recovery is shared between the EU budget and the Member State concerned. Total recoveries recorded amount to only around one third of recorded financial corrections.

<sup>(18)</sup> In cohesion policy, it is the responsibility of Member States to recover unduly paid amounts from beneficiaries where appropriate and to report to the Commission on recoveries from beneficiaries and amounts withdrawn from expenditure declarations. (Article 70 of Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999 (OJ L 210, 31.7.2006, p. 25)). Note 6.7 of the consolidated accounts presents as withdrawals and recoveries (based on data provided by Member States) a total of 1 652 million euro of additional corrections relating to the 2007-2013 programming period, without distinction between corrections linked to national checks or checks carried out by the Commission.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Financial corrections in 2012**

1.29. Many financial corrections are made several years after initial disbursement of funds (see the Court's special reports No 7/2010 for agriculture <sup>(19)</sup> and No 3/2012 for the Structural Funds <sup>(20)</sup>). There are, however, some significant examples of the Commission succeeding in imposing financial corrections with much greater speed in 2012. Other examples below provide an insight into some of the issues involved (see boxes 1.1 to 1.3).

**1.29.** *The Commission has taken all the necessary measures under the Treaty and foreseen in the regulations in order to protect the EU budget. The Commission does so, whenever feasible, within the financial year in which irregularities occur or are identified, whether by the Court, the Member States or itself. However, due to the legal framework for protecting the Union financial interests and the complexity of the related procedures, most irregularities and/or errors are only addressed several years after they have occurred.*

*Notably in the framework of the preparation for the implementation of the CAP reform, the Commission will continue in its efforts to improve and speed up the process, bearing in mind the need to maintain quality standards and the Member State's right of reply.*

*For the Structural Funds, two third of the cumulative financial corrections over the period 2000-2012 were decided after the adoption of the Commission Action Plan of 2008. This demonstrates an acceleration of procedures, as the Commission had committed itself to do.*

<sup>(19)</sup> Special report No 7/2010, 'Audit of the clearance of accounts procedure', paragraphs 68 to 73 and Graph 3, see ECA website: <http://eca.europa.eu>

<sup>(20)</sup> See chapter 4 (paragraph 4.31) and special report No 3/2012, 'Structural funds: did the Commission successfully deal with deficiencies identified in the Member States' management and control systems?', ECA website: <http://eca.europa.eu>

## THE COURT'S OBSERVATIONS

**Box 1.1 — Example of a prolonged financial correction procedure**

European Regional Development Fund (ERDF) — Spain

The 2012 accounts record a 1,8 billion euro financial correction on the 2000-2006 use of cohesion policy funds in Spain. This is the largest single correction recorded in 2012 (49 % of the total). The Commission proposed the correction in 2008, seeking to address weaknesses in management and breaches of public procurement rules.

Authorities in the Member State agreed to the correction at closure of the programme in 2011 and 2012. In order to give effect to this correction, Spanish regions responsible for the management of the programmes declared further expenditure.

As a result of the corrections, authorities in Spain were entitled to further funding amounting to 1 390 million euro. Of this, the Commission paid only 211 million euro in 2012 because of the unavailability of payment appropriations (see paragraphs 1.46 to 1.59). This payment led to the recognition of the financial correction in the consolidated accounts. The Commission will pay the remaining 1 179 million euro to Spain in 2013. Spain will therefore receive 27 864 million euro of the 28 019 million euro available to it (all but 155 million euro available) for the 2000-2006 programme period.

## THE COMMISSION'S REPLIES

**Box 1.1 — Example of a prolonged financial correction procedure**

*European Regional Development Fund (ERDF) — Spain*

*The Commission considers this complex corrective process which resulted in the replacement of more than 2 billion euros by new eligible expenditure as a success for the protection of the EU budget.*

## THE COURT'S OBSERVATIONS

**Box 1.2 — Examples of flat-rate financial corrections — impacting at Member State level***European Social Fund (ESF) — Romania*

The Commission identified serious problems in a Romanian ESF operational programme (OP) in April/May 2012. The main issues included deficient selection procedures, deficient management verifications, insufficient checks on public procurement and ineligible expenditure for individual cases.

After negotiation, the Commission and Romanian authorities agreed on a 25 % flat-rate correction. As a result Romania made a further declaration of ESF expenditure (exceeding 25 % of all expenditure declared previously), on the basis of which the Commission paid a small amount (7 602 euro) to Romania in December 2012. Corrections (which up to 31 December 2012 amounted to 81 million euro of the EU contribution) were not made at project level, and the impact of the financial correction is equivalent to lowering the co-financing rate for this OP.

*ERDF — Czech Republic*

In 2011 the Commission, the Court and authorities in the Member State identified serious deficiencies in the functioning of the management and control systems in two operational programmes (OP Environment (65 million euro EU contribution) and OP Transport (194 million euro EU contribution)). Based on its verifications and the estimated risk for the fund, the Commission and Czech authorities agreed on a flat-rate correction (5 % for OP Environment and 10 % for OP Transport) for all expenditure paid by the managing authority to beneficiaries before 1 September 2012. In this relation, the Czech authorities accepted to deduct the agreed correction in subsequent expenditure declarations to the Commission leading to a reduced reimbursement from the Commission concerning these beneficiaries.

## THE COMMISSION'S REPLIES

**Box 1.2 — Examples of flat-rate financial corrections — impacting at Member State level***European Social Fund (ESF) — Romania*

The Commission notes that, whilst acknowledging that it has done everything within its power and acted in full respect of the existing regulations, the Court does not reduce the estimated error rate for 2012 on the basis of the flat rate correction to which the Court refers for the policy area of Employment and Social Affairs. In its own assessment of the level of estimated error in 2012, the Commission also takes into account the impact of flat-rate corrections within the year, which are excluded from the Court's estimation of the error rate. On this basis, the Commission considers that the error rate is broadly in line with the error rate calculated previously for this Policy area (see paragraphs 6.14 and 6.39).

The impact of financial corrections is not only equivalent to lowering the co-financing rate for the related OP; more relevant is that as a result the expenditure incurred in breach of law concerned is excluded from Union expenditure.

*ERDF — Czech Republic*

The Commission has made in 2012 flat rate financial corrections on a cumulative basis to all expenditure in the concerned Czech programmes. The Commission notes that, whilst it has done everything within its power and acted in full respect of the existing regulations in order to protect the EU budget within the same financial year audited by the Court, the above flat rate correction has not affected the Court's calculation of the 2012 estimated error rate (see paragraphs 5.26, 5.33 and 5.62).

## THE COURT'S OBSERVATIONS

**Box 1.3 — Examples of financial corrections — impacting at beneficiary level***ERDF — Romania*

For one Romanian ERDF operational programme, the Commission identified from 2010 to 2012 serious deficiencies in management and control systems in general, and deficiencies in public procurement.

After payment interruption the Commission agreed with Romanian authorities that individual corrections be carried out at project level. This was reflected in the reimbursement the Commission paid to Romania in December 2012.

*ERDF — Slovakia*

The Commission and the Slovak audit authority identified serious deficiencies in public procurement procedures. The national authorities verified a representative sample of contracts. Based on this work Slovakia accepted a correction of 7,3 % (amounting to 32 million euro of the EU contribution up to the end of 2012) based on an extrapolation of test results applying to each of the 1 919 individual contracts signed before 30 October 2012.

## THE COMMISSION'S REPLIES

**Box 1.3 — Examples of financial corrections — impacting at beneficiary level***ERDF — Romania*

The Commission draws attention to the proactive corrective actions it took in the form of interruption of payments and substantial financial corrections in respect of 4 of the 5 mainstream ERDF programmes in Romania, where it had identified serious deficiencies through its audit work. The programmes have been corrected at flat rate within a range from 10 to 25 % depending on the specific situation of each priority axis.

*ERDF — Slovakia*

The Commission has made in 2012 flat rate financial corrections on a cumulative basis to all expenditure in the concerned Slovak programme. The Commission notes that, whilst it has done everything within its power and acted in full respect of the existing regulations in order to protect the EU budget within the same financial year audited by the Court, the above flat rate correction has not affected the Court's calculation of the 2012 estimated error rate (see paragraphs 5.26, 5.33 and 5.62).

The Commission notes that the Court considered that the flat rate correction impacted individual projects in the Slovak example only when these had been subject to individual audits in the frame of the representative sample of 77 contracts which formed the basis for the extrapolation and were thus subject to detailed, individual corrective action. In another project, subject to the flat rate correction but not part of the representative sample audited by the Member State, the Court considered that the error it detected was not corrected despite the flat rate correction and therefore included it in its error rate. Extending management checks and audits on individual projects would have significant cost implications for the Commission and the Member States and therefore, flat rate corrections are applied in accordance with the legislative framework.

**Impact on the Statement of Assurance**

1.30. The Court welcomes the quicker action taken by the Commission in making financial corrections for Romania, the Czech Republic and Slovakia. It notes the progress made on the long-outstanding financial correction for Spain. The timing and nature of the financial corrections affects their impact on the budget, on Member States, on beneficiaries and on the work of the Court.

## THE COURT'S OBSERVATIONS

1.31. The Court has considered the impact that these corrections have on its audit conclusions:

- (a) The financial correction for Spain (see box 1.1) addresses problems found up to 2008. However, payments will continue to be made in 2013 (and possibly later budget years) and these may be examined by the Court through its normal cycle of audit work.
- (b) The Romanian ESF and the Czech ERDF corrections were flat-rate corrections. The corrections made do not involve recoveries (see box 1.2) from beneficiaries, or detailed correction at project level. Thus the errors identified by the Court remain part of expenditure <sup>(21)</sup> declared by the Member States in order to justify reimbursement.
- (c) The Romanian ERDF correction and a component of the Slovak ERDF correction (see box 1.3) were made during 2012, and incorporated detailed corrections at project level. The Court has taken account of this when examining projects affected by the correction: errors on these projects were no longer quantified by the Court and are therefore excluded from the estimation of the error rate <sup>(22)</sup>.

## THE COMMISSION'S REPLIES

1.31.

- (a) *The financial correction for Spain was made in 2012 based on (partial) final payments. Therefore this correction contributes to ensuring that the payments made in 2012 by the Commission are not triggered by expenditure incurred in breach of law.*

*In addition the Commission notes that payments, errors and corrections under cohesion policy have to be assessed in the multiannual context of programmes. The Commission has recently shown in a report requested by the discharge authority that financial corrections by the Commission for 2000-2006 programmes, taking also account of additional corrections made by Member States and including this financial correction to Spain, reach at least 5,6 % of the 2000-2006 ERDF allocations (and 6,2 % at 31 March 2013).*

- (b) *While payments made by the Commission covered projects which may have contained irregularities, the Commission considers that due to the flat rate corrections the incorrectly declared expenditure of the final beneficiaries is not subject to reimbursement from the EU budget (see chapter 5 (paragraphs 5.26, 5.33 and 5.62) and chapter 6 (paragraphs 6.14, 6.15, 6.37 and 6.40).*
- (c) *See Commission's reply in box 1.3. This was the case for some Slovak projects, included in the Court's sample which formed the basis for the flat rate correction of 7,3 % to almost 2 000 projects. Another Slovak project, not individually audited by the Member State prior to the Court's audit, did contribute to the error rate of the Court. This unequal treatment between projects subject to the same flat rate correction contradicts the principal of cost-effectiveness of controls and the reasons underlying the use of flat rate corrections foreseen in the Financial Regulation.*

<sup>(21)</sup> See paragraph 1.40 of the Court's 2009 annual report.

<sup>(22)</sup> See paragraph 1.39 of the Court's 2009 annual report.



## THE COURT'S OBSERVATIONS

1.32. For agricultural expenditure the Commission's conformity decisions address Member States and do not, in most cases, lead to recoveries from beneficiaries (see paragraph 1.26) and reflect expenditure in the past (see paragraph 4.28 of chapter 4). The effects of these financial corrections are therefore too late to affect the Court's assessment of the level of error for the current reporting year.

1.33. Financial corrections initiated by the Commission that have led to detailed correction of project expenditure or reimbursement during the year have reduced the estimated error rate for 2012. Flat-rate financial corrections, which do not remove irregular expenditure from the declaration or correct irregular expenditure at project level, do not impact on the estimated error rate of the Court.

1.34. The Commission makes significant efforts to identify and improve non-performing supervisory and control systems as required by EU legislation. The Commission cannot move beyond these actions, i.e. force Member States to recover from beneficiaries.

## THE COMMISSION'S REPLIES

**1.32.** The Commission considers that financial corrections cover adequately the risk to the EU budget for shared management expenditure. They do not relieve the Member States from the obligation to recover the undue payments from the beneficiaries whenever it is feasible and cost-effective. With regard to the timing of the financial corrections, the Commission will continue in its efforts to improve and speed up the process, notably in the framework of the preparation for the implementation of the CAP reform, bearing in mind the need to maintain quality standards and the Member State's right of reply. This is why the Commission considers that the financial corrections and recoveries done ex post in application of EU rules should be taken into account to reflect the extent to which over time expenditure remains affected by transactions carried out in breach of law after the operation of supervisory and control system.

**1.33.** The Commission underlines that flat rate corrections protect the EU budget by excluding expenditure incurred in breach of law from Union financing.

See replies to paragraphs 1.29 to 1.31.

**1.34.** In parallel to the implementation of financial corrections, all systemic issues identified are addressed through the implementation of action plans involving changes in management and control systems, which are implemented by the Member State concerned.

The European Parliament resolution on the integrated internal control framework adopted in July 2013 requested a strict application of Article 32(5) of the Financial Regulation which states: 'If, during implementation, the level of error is persistently high, the Commission shall identify the weaknesses in the control systems, analyse the costs and benefits of possible corrective measures and take or propose appropriate action, such as simplification of the applicable provisions, improvement of the control systems and re-design of the programme...'

In particular due to the expected reduction of human resources, difficulties in the legislative procedure for the period 2014-2020 to ensure the proposed simplification and the objective of cost-effective controls, the Commission considers that especially in the area of shared management the implementation of this new requirement cannot be limited to actions which only focus on achieving an impact on the annual error rate at the level of final recipients. Financial corrections and recoveries at the level of the Member States, which are implemented during the lifetime of multi-annual programmes, will always be an important factor to be taken into consideration as well as the continued efforts to simplify rules, redesign and strengthen systems.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.35. For the 2014-2020 programme period the Commission has proposed that irregularities detected subsequent to presentation of the annual account of the national authorities should lead automatically to a net reduction of EU funding, thus increasing the incentive for effective checks by Member States<sup>(23)</sup>. If such a proposal is adopted, the Court will consider whether there are implications for its methodology.

**1.35.** *The Commission notes that, following the Court's present approach, net reductions of EU funds do not have an impact on the error rate, if Member States fail to recover the amounts from final recipients or if they concern prior years.*

## The synthesis report and the annual activity reports

### Annual activity reports

1.36. The Commission delegates day-to-day management of the budget to the directors-general of Commission directorates-general and the chief operating officer of the European External Action Service (directors-general<sup>(24)</sup>). The Commission requires these directors-general to provide declarations of assurance on the legality and regularity of underlying transactions within annual activity reports<sup>(25)</sup>. Commission instructions on the preparation of the declarations state that directors-general should qualify them (a) where an event has occurred with serious implications for the reputation of the Commission or (b) when the impact of estimated levels of error, net of financial corrections and recoveries already made, remains material.

<sup>(23)</sup> See the Court's 2011 annual report, paragraph 5.73, recommendation 1: 'The Court recommends that the Commission makes sanction systems more effective by increasing the impact of financial corrections and by reducing the possibility of replacing ineligible expenditure with other expenditure as proposed by the Commission in the area of cohesion for the next programming period.'

<sup>(24)</sup> The term 'director-general' is used here to cover all persons signing declarations. The declarations have been signed by the Secretary-General of the Commission, 36 directors-general, seven directors and four heads of service and the chief operating officer of the European External Action Service.

<sup>(25)</sup> The annual activity reports of Commission services are available on the Commission's website: [http://ec.europa.eu/atwork/synthesis/aar/index\\_en.htm](http://ec.europa.eu/atwork/synthesis/aar/index_en.htm).

## THE COURT'S OBSERVATIONS

1.37. In 2012 all the directors-general declared that they had 'reasonable assurance that the resources assigned to the activities of the service had been used for their intended purpose and in accordance with the principles of sound financial management, and that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions'. However, 14 directors-general made a total of 23 quantified reservations related to expenditure (see **Table 1.3**). In addition, as in the previous year, the Director-General of DG Budget qualified his declaration on revenue.

1.38. Three directorates-general<sup>(26)</sup> were subject to a 'limited review' by the Internal Audit Service. As a result, DG Agriculture and Rural Development reports larger reservations than in the past. DG Development, Cooperation – EuropeAid and DG Research and Innovation also report larger reservations, although these are not linked to the conclusions of the limited reviews of the Internal Audit Service. Not all of the recommendations on annual activity reports were implemented in the 2012 annual activity reports and the Internal Audit Service is continuing its examination of a further range of directorates-general for the 2013 annual activity reports.

## THE COMMISSION'S REPLIES

**1.38.** *The Commission's services have committed to implement all IAS recommendations for the 2013 AAR exercise.*

<sup>(26)</sup> DG Agriculture and Rural Development (see chapter 3, paragraphs 3.31 to 3.36, and chapter 4, paragraphs 4.38 to 4.40), DG Development and Cooperation – EuropeAid (see chapter 7, paragraph 7.24 and box 7.2) and DG Research and Innovation (see chapter 8, paragraph 8.24).

Table 1.3 — Quantified reservations in Commission annual activity reports

(million euro)

Chapter	DG/Service <sup>(1)</sup>	Reason for reservation <sup>(2)</sup>	Total payments under reservation for relevant ABB activities <sup>(3)</sup>	Quantification of reservations <sup>(2)</sup>	Amount at risk <sup>(4)</sup>	
3	AGRI	Serious deficiencies in Member States control systems for direct support payments in Bulgaria, France and Portugal	40 880,0	407,3	932,1	
4	AGRI	Errors detected by Member States in rural development expenditure	13 257,8	202,7	202,7	
	MARE	Management and control systems for the FIFG Operational Programmes in Germany (objective 1)	2,4	0,0	0,0	
		EFF management and control systems in Belgium, Czech Republic, Estonia, Spain, France, Italy, Romania, Sweden and United Kingdom	477,6	21,1	21,1	
	SANCO	Errors in Member States cost claims for animal disease eradication and monitoring programmes in the food and feed policy area	256,0	8,8	8,8	
5	REGIO	ERDF/Cohesion Fund/IPA management and control systems for the 2007-2013 programming period in 16 Member States and 12 European Territorial Cooperation programmes	35 474,5	309,5	min.	769,5
		ERDF/Cohesion Fund management and control systems for the 2000-2006 programming period in 5 Member States	2 612,7	10,9	max.	1 716,9
6	EMPL	Weaknesses in management and control systems for ESF in Belgium, Czech Republic, Germany, Ireland, Spain, France, Italy, Poland, Romania, Slovakia and United Kingdom for 2007-2013 programming period	10 719,0	68,0	250,2	
		Weaknesses in management and control systems for IPA in two candidate countries	58,5	0,9	0,9	
7	DEVCO	Legality and regularity of transactions considered at risk (global figure for the Directorate-General)	3 853,3	138,7	259,5	
	FPI	Potential legality and regularity issues and risks arising from election observation missions (EOMs)	25,9	2,2	2,2	
8	RTD	Errors in cost claims for sixth framework programme (FP6) grants	323,4	8,2	8,2	
	ENER		17,0	1,1	1,1	
	MOVE		7,0	0,7	0,7	
	ENTR		2,8	0,1	0,1	
	RTD	Errors in cost claims for seventh framework programme (FP7) grants	3 456,4	103,1	103,1	
	CNECT		1 160,8	15,9	15,9	
	ENTR		329,3	2,4	2,4	
	ENER		135,1	3,1	3,1	
	MOVE		56,0	0,5	0,5	
	REA	Errors in cost claims for FP7 grants for Space and Security	239,4	4,2	4,2	
		Errors in cost claims for FP7 grants for Small and Medium sized Enterprises	194,6	7,7	7,7	
	EACEA	Errors in grant payments from the 2011-2012 budget for the LLP programme (2007-2013)	120,0	4,2	4,2	
Total			113 659,5	1 321,3	min.	2 609,1
					max.	3 556,5

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(<sup>1</sup>) For the full list of Commission DGs/services please see <http://publications.europa.eu/code/en/en-390600.htm>

(<sup>2</sup>) *Source*: annual activity reports of the directorates-general, services and executive agencies; 'reason for reservation' adjusted from Part 3.2 (titles) or Part 4, 'quantification of reservations' as from Part 3.1 and Part 3.2.

For DG MARE see also annual activity report, page 67, however quantified at 0,0 euro because no payments were made in 2012; for DG REGIO including 1,5 million euro for IPA 2007-2013; for DG DEVCO calculated excluding EDF at  $3\,853,2 \times 3,6\%$ ; for the executive agency EACEA the quantification in the annual activity report is for two years, this table includes 50 % of 8,4 million euro.

(<sup>3</sup>) *Source*: 2012 consolidated accounts, payments made in 2012 on 'Activity Based Budgeting' (ABB) items.

(<sup>4</sup>) This column presents the Commission's quantification of the 'amounts at risk' in the synthesis report. This is based upon the quantification of reservations in the annual activity reports together with, for shared management, quantification of the overall risk for payments to operational programmes not under reservation. For DG DEVCO the figure includes quantification on EDF spending (*Source*: annual activity reports, Part 3.1 and Part 3.2). The methodology for quantifying the 'amounts at risk' in the synthesis report has changed in comparison with previous years.

The amounts are based on information from the annual activity reports: DG AGRI, page 54, Table 3.2 (16,7 + 915,4 million euro), DG REGIO, pages 67 and 68 (see chapter 5, paragraph 5.54), DG EMPL, table on page 71.

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## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**The synthesis report**

1.39. The Synthesis of the Commission's Management Achievements in 2012 (the 'synthesis report')<sup>(27)</sup>, was adopted by the Commission on 5 June 2013. The synthesis report is both:

- (a) an instrument for internal accountability within the Commission for the use made of the budget by directorates-general;
- (b) an instrument for external accountability ('political responsibility' in the words of the Commission).

1.40. The synthesis report does not have to include an explicit declaration that funds have been spent in accordance with the regulations of the kind that EU law now requires of national bodies which are responsible for managing EU funds<sup>(28)</sup>.

1.41. The synthesis report brings together<sup>(29)</sup> the 'amounts at risk' identified in the individual annual activity reports (see **Table 1.3**). The term 'amounts at risk' is not defined within the synthesis report and is not calculated on a consistent basis by the various directorates-general<sup>(30)</sup>. In total the Commission quantifies the 'amount at risk' at between 1,9 % (2,6 billion euro) and 2,6 % (3,5 billion euro) of total payments of the year. The Commission, therefore, acknowledges that the level of error in expenditure is likely to be material. It is not possible directly to compare the Commission's quantification of 'amounts at risk' with the Court's estimate of error. However, the synthesis report itself states that 'amounts at risk in a number of areas, in particular Rural Development, are likely to be underestimated due to reliability problems detected by the IAS'. As a result, the Commission included in its synthesis report an instruction to its central services to review different approaches followed to evaluate the amounts estimated to be at risk (see footnote 30).

**1.39.** The synthesis report is the document adopted by the College on the basis of the annual activity reports and the overall opinion of the Internal Auditor, taking into account the annual report of the Court and the discharge resolution from the European Parliament, by which the Commission takes overall political responsibility for management of the EU budget, in line with article 317 of the TFEU.

**1.40.** The explicit declaration that funds have been spent in accordance with the regulations is included in the annual activity reports of the directors-general. The governance structure decided for the European Commission puts this responsibility at the level of the directors-general while the political responsibility lies with the College. This is confirmed by the Financial Regulation (Article 66(9)).

**1.41.** For the Commission's approach in terms of quantification of the residual error in a multiannual control environment, and thus the related exposure (amount at risk), see the Commission's reply to paragraph 1.12.

As shown in the synthesis report the Commission is aware of the issues raised by the Court and is taking measures to harmonise the methodologies to calculate the amount at risk.

It is important to take into consideration that the existing problems are primarily caused by unreliable error rates communicated by Member States. The Commission invests a lot of efforts in order to improve their reliability, in particular by correcting them upwards if deemed necessary (see replies to paragraphs 3.31 to 3.36, 4.38 to 4.39 and 6.35 to 6.39).

<sup>(27)</sup> The synthesis is published on the Commission's website:

[http://ec.europa.eu/atwork/pdf/synthesis\\_report\\_2012\\_en.pdf](http://ec.europa.eu/atwork/pdf/synthesis_report_2012_en.pdf),  
together with its annex

[http://ec.europa.eu/atwork/pdf/synthesis\\_report\\_2012\\_annex\\_en.pdf](http://ec.europa.eu/atwork/pdf/synthesis_report_2012_annex_en.pdf)

<sup>(28)</sup> See Article 59(5)(a) of the Financial Regulation (EU, Euratom) No 966/2012.

<sup>(29)</sup> Synthesis of the Commission's Management Achievements in 2012, section 4, page 8.

<sup>(30)</sup> Synthesis report, p. 8, box 1: 'To ensure consistency and comparability, the Commission instructs the Central Services to review the different approaches followed to evaluate the amounts estimated to be at risk'.

## THE COURT'S OBSERVATIONS

1.42. The synthesis report compares the total for 'amounts at risk' with the average level of financial corrections over the last four years, and notes that the average level of financial corrections and recoveries over the last four years is close to the level of the amount at risk for 2012. This juxtaposition needs to be put into context:

- the Court has discussed the timing of financial corrections and their impact on Member States and beneficiaries in paragraphs 1.19 to 1.35,
- the synthesis report recognises that the quantification of 'amounts at risk' is likely to be understated because of the methods used in, for example, cohesion policy (see chapter 5, paragraphs 5.57 and 5.58) and rural development (see chapter 4, paragraph 4.38) and deficiencies in information provided to the Commission by other bodies managing EU funds,
- the result of a financial correction is typically the declaration of new expenditure by the Member State concerned, which could itself be subject to error.

1.43. The synthesis report is not restricted to a discussion of legality and regularity. Other significant matters dealt with in the synthesis report include instructions to Commission services to improve the performance framework in order to achieve a 'performance-driven culture throughout the organisation' <sup>(31)</sup>. In addition, the Commission expresses its concern that several of the proposals for sectoral legislation it has made for the new programme period, aimed at ensuring a simpler legal framework, are not being taken up.

## THE COMMISSION'S REPLIES

**1.42.** As developed in the synthesis report and based on the experience of the last four years (2009-2012), financial corrections and recoveries compare favourably to the amounts estimated to be at risk. This approach using average financial corrections and recoveries can even be considered conservative, given that a higher level of error in one year is likely to trigger a higher level of financial corrections and recoveries in the future. The approach developed in the Commission's reply to paragraph 1.12 reinforces this view. Therefore, taking into account the materiality threshold of 2 % the Commission considers that the budget as a whole is protected despite likely underestimations of some amounts at risk. See replies to paragraphs 1.19 to 1.35.

- The design of the multiannual correction mechanisms in the Financial Regulation and the sectorial regulations determine to a large extent their timing and impact on Member States and beneficiaries. This multiannual legal framework is not necessarily aligned with an annual approach. The Commission's synthesis report obviously takes into consideration the existing legal framework as regards the corrective capacity of multiannual supervisory and control systems.
- The Commission has invested big efforts in improving the reliability of the error statistics of the Member States. While the Commission accepts that there are still problems, its actions have ensured that risks disclosed in annual activity reports and the synthesis report provide, in general, a fair view of the residual error rate.
- Replacing ineligible expenditure with new eligible expenditure is fully in accordance with the legal framework. The intention of the legislator was to ensure that the funds are effectively spent on eligible projects in Member States.

The Commission's proposal for the Common Provisions Regulations covering the Structural Funds for the period 2014-2020, provides for financial corrections reducing the budgetary allocation to the particular Member State, thus has a net reduction effect, in case the weakness/deficiency was not identified by the Member State. This will set better incentives for Member States to operate an effective supervisory and control system.

<sup>(31)</sup> The Court's assessment of reporting on performance in three selected directorates-general is presented in chapter 10.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Overall assessment**

1.44. The synthesis report juxtaposes the level of funds spent in breach of regulation, and the impact of financial corrections. The Court considers that these figures need to be put into context. The synthesis report itself notes that the figures presented are likely to underestimate the overall level of risk. The Court has set out the inherent limitations of financial corrections as a means of correcting errors (see paragraphs 1.19 to 1.35). Financial corrections can play a significant role in providing incentives for improving the quality of spending, but it is important not to overestimate their impact in ensuring that spending is regular.

**1.44.** *The Commission does not evaluate the impact of financial corrections and recoveries in correcting errors at final beneficiary level; instead it analyses, based on the legal framework defined in Articles 59 and 80 of the Financial Regulation, whether they protect adequately the EU budget as a whole by excluding from Union financing expenditure incurred in breach of applicable law.*

*The Commission applied a prudent approach in order to quantify the related amounts. The Commission included in its analysis only those financial corrections (in 2012 about 3,7 billion euro) and recoveries (in 2012 about 0,7 billion euro) which were implemented by itself and addressed directly errors or risk of errors caused by weaknesses in supervisory and control systems of Member States (in 2012 in total 4,4 billion euro).*

*Following this approach, the Commission did not include:*

- recoveries of advances which were not used due to lack of expenditure incurred (in 2012: about 0,6 billion euro). However, the calculation of the amounts to be reimbursed to the Union budget has to be based on an analysis and validation of the eligibility of the expenditure which forms the basis for the clearing of the related advance and exclusion of expenditure incurred in breach of law, and*
- recoveries and withdrawals implemented by Member States (from 2007 to 2012, for the programming period 2007-2013 due to their own efforts (about 1,6 billion euro) which correct irregular amounts received by final recipients.*

*The Commission considers that the amounts described above should be taken into consideration when analysing the long term impact on legality and regularity of expenditure declared by final beneficiaries. With a view of providing more complete information, the Commission will therefore include them in its future communications on the protection of the EU budget.*

*The Commission states, based on the legal framework defined in Articles 59 and 80 of the Financial Regulation and data available, that it protects adequately the EU budget as a whole by excluding from Union financing expenditure incurred in breach of applicable law.*

## THE COURT'S OBSERVATIONS

1.45. It is for consideration whether the synthesis report continues to be adapted to the achievement of both the internal and external accountability objectives. The synthesis report is finalised in accordance with a timetable set out in the Financial Regulation, but too late for it to be a significant input to the work of the Court of Auditors. It is not published together with the consolidated accounts. The synthesis report does not have to and does not include an explicit declaration of the kind made in other areas <sup>(32)</sup>.

## BUDGETARY MANAGEMENT

1.46. In 2012 the Commission was unable to meet all requests for payment from the available budget. Among the factors influencing this situation were the increase in the gap between appropriations for commitment and payment, and the accumulation of outstanding commitments from previous years <sup>(33)</sup>.

## THE COMMISSION'S REPLIES

**1.45.** The Commission considers that the synthesis report goes significantly beyond the requirements of the Financial Regulation which states in Article 66: 'No later than 15 June each year, the Commission shall send to the European Parliament and the Council a summary of the annual activity reports for the preceding year.' The synthesis report is the document by which the College takes political responsibility on the basis of Article 317 of the TFEU. It contains an analysis of the reservations and their reasons and gives instructions to the services on how to address the remaining weaknesses.

The Commission considers that the combination of the annual activity reports and the synthesis report fulfil the internal and external accountability objectives defined by the Court. The annual activity reports are finalised in time to be taken into account by the Court and they contain an explicit declaration of the kind comparable to other areas. The synthesis report is the summary of the annual activity reports and is the document by which the College takes political responsibility on the basis of Article 317 of the TFEU.

The annual activity reports and the synthesis reports are public documents which are readily available for all stakeholders. The Commission will follow the Court's suggestion to create a link from the consolidated accounts to the pages on which the synthesis report and the annual activity reports are published.

**1.46.** The budget is voted by the budgetary authority. As the 2012 Commission proposal for a budget was cut by the budgetary authority, a request for an amending budget had to be introduced by the Commission to satisfy the Member States' payment claims for regional policy and rural development. However, it was also reduced by the budgetary authority, resulting in a large backlog of 12,1 billion euro of unpaid claims for regional policy at year-end. For rural development, there was a relatively small lack of payment appropriations of 101,4 million euro under the 2012 budget.

<sup>(32)</sup> For example the management declaration required of bodies in the Member States (Article 59(5)(a) of the Financial Regulation) and the corporate governance statements required under Article 46(a) of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (OJ L 222, 14.8.1978, p. 11).

<sup>(33)</sup> See paragraphs 1.36 to 1.38 of the Court's 2011 annual report.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*The Commission used all the tools at its disposal to maximise the implementation of the budget, among which the 'End of year transfer' newly introduced in the Financial Regulation. It allowed pooling together unused credits from all headings and making payments worth 211 million euro under regional policy at end December.*

**Budgetary appropriations for commitments and payments**

1.47. The final EU budget authorised the institutions to enter into commitments amounting to 148,7 billion euro <sup>(34)</sup> and to make payments amounting to 136,8 billion euro <sup>(35)</sup>.

1.48. Full use was made of these appropriations; commitments were entered into amounting to 99,6 % of the authorised total (99,3 % in 2011) and payments were made totalling 99,1 % of the budget limit (98,6 % in 2011).

<sup>(34)</sup> Amounts available for commitments in 2012 and future years. The total for commitments includes a sum of 0,3 billion euro brought forward from 2011 and an amount from six amending budgets totalling 1,2 billion euro. In addition, assigned revenue of 6,3 billion euro, not included in the 148,7 billion euro, was available for commitments. Assigned revenues are used to finance specific items of expenditure (see Article 18 of the Financial Regulation — Council Regulation (EC, Euratom) No 1605/2002 (OJ L 248, 16.9.2002, p. 1)). They cover inter alia refunds arising from recovery of amounts paid in error, which are re-allocated to their budget line of origin, contributions from EFTA members increasing budget lines, and revenue from third parties where agreements have been concluded involving a financial contribution to EU activities.

<sup>(35)</sup> Amounts available for payments in the year. The total for payments includes a sum of 1,1 billion euro brought forward from 2011 and an amount from the same six amending budgets totalling 6,7 billion euro. In addition, assigned revenue of 6,8 billion euro, not included in the 136,8 billion euro, was available for payments.

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THE COURT'S OBSERVATIONS

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1.49. Appropriations for commitment to which the financial framework commitments ceiling applies were 0,8 billion euro below the ceiling. Other commitments, consisting of funds to which the financial framework ceiling is not applicable, totalled 1,2 billion euro <sup>(36)</sup>. In the case of appropriations for payment, spending was within the ceiling by 5,6 billion euro, all funds included.

**The budgetary result**

1.50. Revenue exceeded payments <sup>(37)</sup> by 1,0 billion euro <sup>(38)</sup> in 2012 (1,5 billion euro in 2011). This surplus <sup>(39)</sup> will be used to offset the own resources to be collected from Member States in 2013.

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<sup>(36)</sup> According to the Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management (OJ C 139, 14.6.2006, p. 1), certain commitment appropriations entered in the budget such as the Emergency Aid Reserve, the European Union Solidarity Fund, the Flexibility Instrument and the European Globalisation Adjustment Fund may be over and above the ceiling. In 2012 amounts committed were: Emergency Aid Reserve 224 million euro, European Union Solidarity Fund 688 million euro, Flexibility Instrument 200 million euro and European Globalisation Adjustment Fund 74 million euro, totalling 1 186 million euro.

<sup>(37)</sup> Apart from cash transactions certain payment appropriations brought forward are included. As specified in Article 15 of Council regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the Communities' own resources (OJ L 130, 31.5.2000, p. 1), in the calculation of this surplus, payment appropriations brought forward from the previous year, cancellations of unused payment appropriations from the previous year and exchange differences are taken into account.

<sup>(38)</sup> See Note 1.1 — EU budget result of the consolidated annual accounts of the EU — 2012.

<sup>(39)</sup> The budgetary result (budget outturn) is not a reserve and it cannot be accumulated and used in future years to finance expenditure.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**The pressure on the budget for payments**

1.51. As the Court noted in the 2011 annual report <sup>(40)</sup>, the Commission is finding it increasingly difficult to meet all requests for payment in the year within the budgeted appropriations for payment. In 2012 the Commission sought extra payment appropriations in the fourth quarter of the year. It requested 9 billion euro in appropriations for payment through amending budget No 6 submitted on 23 October 2012, of which 6 billion euro were approved by the budgetary authority on 12 December 2012. The pressure on payments is also reflected in the increase in the amount of outstanding commitments (see paragraph 1.54 and 1.55).

1.52. One factor in this is that appropriations for commitment have been near the ceiling defined in the financial framework throughout 2007-2013, while appropriations for payment have been set below the ceiling during each period (see **Table 1.4**). As a result, the cumulative total of commitment appropriations available over the period 2007-2013 has exceeded the cumulative total of payment appropriations over the same period by 114 billion euro. This is 64 billion euro more than the difference of 50 billion euro between the two totals envisaged in the financial framework.

1.53. Further factors creating pressure on the budget for payments in 2012 include the increase in the flow of payment claims from Member States in the penultimate year of the programme period <sup>(41)</sup> and the response to the slow start up of cohesion spending in the current programme period. This resulted in amending budgets that transferred payment (but not commitment) appropriations to other budget headings, and in the cancellation of some payment appropriations.

**1.51.** See reply to paragraph 1.46.

**1.53.** The Commission agrees that an acceleration of payment claims' submission towards the end of the programming period is a normal feature of multiannual programming. As this trend is known to the Commission, an amending budget was proposed in 2012 to anticipate the lack of appropriations (see also reply to paragraph 1.46).

The amending budget included only payment appropriations: no additional commitment appropriations are needed as they are determined in the multiannual financial framework.

<sup>(40)</sup> See paragraphs 1.34 and 1.38 of the Court's 2011 annual report.

<sup>(41)</sup> See 'Report on Budgetary and Financial Management — Financial Year 2012'.

**Table 1.4 — Comparison between the 2007-2013 financial framework and the annual budgeted appropriations**

(million euro)

	2007	2008	2009	2010	2011	2012	2013 <sup>(1)</sup>	Total
<i>Established in the framework</i>								
(A) Commitment appropriations	124 457	132 797	134 722	140 978	142 272	148 049	152 502	975 777
(B) Payment appropriations	122 190	129 681	120 445	134 289	133 700	141 360	143 911	925 576
(C) Gap established in the framework (A) – (B)	2 267	3 116	14 277	6 689	8 572	6 689	8 591	50 201
<i>Voted budgets <sup>(2)</sup></i>								
(D) Voted payment appropriations in annual budgets	113 844	115 772	113 410	122 956	126 727	135 758	132 837	861 304
(E) Additional gap created (B) – (D)	8 346	13 909	7 035	11 333	6 973	5 602	11 074	64 272
(F) Total gap (C) + (E)	10 613	17 025	21 312	18 022	15 545	12 291	19 665	114 473

<sup>(1)</sup> The 2013 figure under (D) states the amount voted before any amending budgets.

<sup>(2)</sup> The voted commitment appropriations were near the amount established in the framework and have not been presented here.

#### THE COURT'S OBSERVATIONS

##### Outstanding budgetary commitments

1.54. The Commission's outstanding budgetary commitments <sup>(42)</sup>, for which payment and/or decommitment have not yet been made, increased by 10 billion euro (5,0 %) to 217 billion euro, and represent the equivalent of 2 years and 3 months worth of differentiated commitments <sup>(43)</sup> or 2 years and 7 months of differentiated payments at the 2012 spending rate.

<sup>(42)</sup> A further 0,6 billion euro of outstanding budgetary commitments is for the other institutions. This amount brings the total outstanding budgetary commitments of the EU to 218 billion euro.

<sup>(43)</sup> The budget distinguishes between two types of appropriation: non-differentiated appropriations and differentiated appropriations (made up of differentiated commitments and differentiated payments). Non-differentiated appropriations are used to finance operations of an annual nature, e.g. administrative expenditure. Differentiated appropriations were introduced to manage multi-annual operations; the related payments can be made during the year of the commitment and during the following years. Differentiated appropriations are used mainly for the structural funds and the Cohesion Fund.

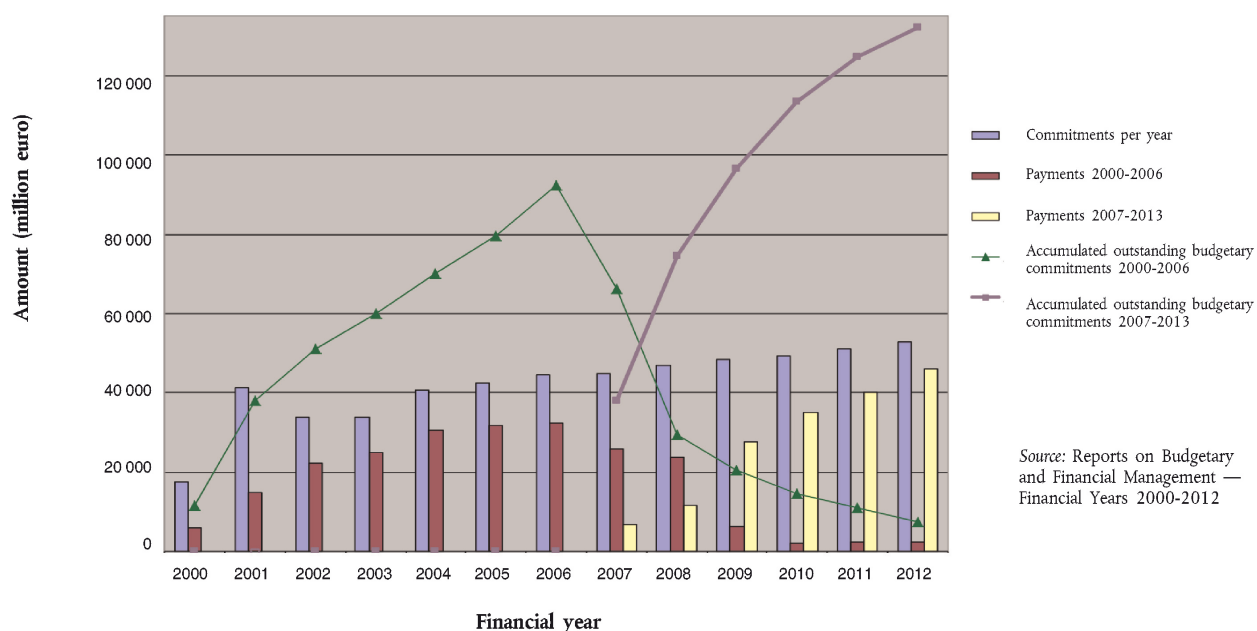
## THE COURT'S OBSERVATIONS

1.55. Most outstanding commitments concern Heading 1b (cohesion for growth and employment) (see **Graph 1.4**). In this field, outstanding commitments amounted to 140 billion euro <sup>(44)</sup> (64,1 % of the total outstanding budgetary commitments), representing 2 years and 8 months worth of commitments or 2 years and 11 months worth of payments (2011: 3 years and 2 months) in that area at the 2012 spending rate. The ratio of outstanding commitments to annual budgets is, however, similar in other areas subject to differentiated appropriations. The decrease in the number of years' worth of payments compared to 2011 is mainly due to 4,4 billion euro payment appropriations allocated to cohesion from amending budget No 6. Despite this increase in payment appropriations, 16,2 billion euro of claims for payment were outstanding <sup>(45)</sup> at the end of 2012 (10,7 billion euro at the end of 2011 and 6,4 billion euro at the end of 2010). Thus, the amount to be met from future budgets for payments has increased significantly over the last three years.

## THE COMMISSION'S REPLIES

**1.55.** In addition to requests which could not be paid at year-end because of lack of appropriations (see reply to paragraph 1.46), there will always be late payment requests remaining unpaid at year-end due to the deadline of 31 December in N + 2/3 rules.

**Graph 1.4 — Development of accumulated outstanding commitments of the Structural Funds and the Cohesion Fund 2000-2006 and Cohesion area 2007-2012**



Source: Reports on Budgetary and Financial Management — Financial Years 2000-2012

<sup>(44)</sup> Two lines on **Graph 1.4** make up the 140 billion euro. The line of the 2000-2006 accumulated outstanding budgetary commitments (8 billion euro) and the line of the 2007-2013 accumulated outstanding budgetary commitments (132 billion euro). For cohesion details see 'Report on Budgetary and Financial Management — Financial Year 2012', p. 25 and 39 to 42.

<sup>(45)</sup> This amount included both claims that had been approved for payment and claims that have arrived but not yet verified or approved. See 'Report on Budgetary and Financial Management — Financial Year 2012', p. 39.

## THE COURT'S OBSERVATIONS

**Outstanding pre-financing**

1.56. The liquidation of a commitment (by a payment) does not necessarily end the process of recording expenditure. The Commission records final expenditure only when activities have been undertaken, reported to it, and accepted. **Table 1.5** shows the level of pre-financing disbursements on which the Commission has not yet accepted and validated final use by beneficiaries. Gross pre-financing amounted to 80,1 billion euro at the end of 2012 <sup>(46)</sup>.

1.57. The longest average period from commitment to acceptance of expenditure is for Heading 4 (EU as a global player), where for a typical operation 3 years and 11 months <sup>(47)</sup> elapse between a commitment being made, and the Commission recording the final related expenditure. Unnecessarily extended periods of pre-financing can lead to an increased risk of error or loss (see chapter 7, box 7.1).

## THE COMMISSION'S REPLIES

**1.56.** According to Article 90(4) of the Financial Regulation, pre-financing shall be cleared (meaning that expenses are recorded) regularly and according to the economic nature and timing of the underlying project. The cut-off exercise each year allocates the relevant expenses to the appropriate period, even if a (final) cost claim has not yet been reported or accepted.

**1.57.** The Commission highlights that, given the particularities of external actions, according to Article 184(4) of the updated Financial Regulation (applicable from 1 January 2013), an exception has been foreseen for external actions so that up to two pre-financing payments can remain open throughout the underlying action.

<sup>(46)</sup> The net figure of 57,7 billion euro shown in the balance sheet reflects the remainder after the Commission's estimation of the extent to which beneficiaries have fulfilled the conditions for aid. Some DGs fail to record final expenditure even when they are in possession of elements indicating that real progress has been made (paragraph 1.29 of the Court's 2010 annual report and paragraph 1.12 of the Court's 2009 annual report).

<sup>(47)</sup> This time span corresponds to a total of 3 years and 11 months in **Table 1.5**, consisting of 2 years and 5 months on average for outstanding budgetary commitments and 18 months on average for pre-financing.

Table 1.5 — Commission's outstanding budgetary commitments and pre-financing per financial framework heading and in years of commitments (payments)

(million euro)

<b>Outstanding budgetary commitments</b>										
Heading		< 2007	2007	2008	2009	2010	2011	2012	Total	Years of commitments <sup>(1)</sup>
1	Sustainable growth <sup>(4)</sup>	7 986	499	2 978	11 444	30 896	50 154	62 314	166 271	2,5
2	Natural resources	806	66	144	286	1 893	8 987	14 703	26 886	1,7
3	Citizenship, freedom, security and justice	19	28	86	241	314	562	1 065	2 316	0,8
4	EU as a global player	1 322	710	1 291	2 199	3 464	4 884	7 558	21 429	2,4
5	Administration	—	—	0	0	0	3	317	320	0,0
	<b>Total</b>	<b>10 133</b>	<b>1 304</b>	<b>4 498</b>	<b>14 171</b>	<b>36 568</b>	<b>64 591</b>	<b>85 958</b>	<b>217 222</b>	<b>2,3</b>
<b>Pre-financing</b>										
Heading		< 2007 <sup>(2)</sup>	2007	2008	2009	2010	2011	2012	Total	Years of payments <sup>(3)</sup>
1	Sustainable growth <sup>(4)</sup>	4 532	7 149	12 758	13 633	5 367	6 083	8 322	57 844	1,0
2	Natural resources	1 454	3 934	2 728	172	116	164	290	8 857	0,2
3	Citizenship, freedom, security and justice	4	10	110	357	400	872	1 955	3 708	1,7
4	EU as a global player	311	210	433	990	1 536	2 632	3 866	9 979	1,5
5	Administration	1	0	—	0	0	0	6	8	0,0
	<b>Total (gross pre-financing)</b>	<b>6 302</b>	<b>11 303</b>	<b>16 030</b>	<b>15 152</b>	<b>7 419</b>	<b>9 751</b>	<b>14 438</b>	<b>80 395</b>	<b>0,6</b>

<sup>(1)</sup> Source: Report on budgetary and financial management — 2012 — section A.6.3.

<sup>(2)</sup> A part of the pre-financing paid before 2007 has been allocated to the corresponding financial framework heading based on the DG responsible as the information concerning the budget line was not available in the Commission's information system.

<sup>(3)</sup> Pre-financing paid as at 31.12.2012 divided by payment made from the year's appropriations.

<sup>(4)</sup> Heading 1 — Sustainable growth is made up of Headings 1a — Competitiveness for Growth and Employment and 1b — Cohesion for Growth and Employment.

## THE COURT'S OBSERVATIONS

**Future disbursement needs**

1.58. Key factors contributing to the pressure on the budget for payments in 2012 include the significant differences in the imbalances noted in paragraph 1.52, and the need to deal with the outstanding balance of unused commitments. The pressure on the budget for payments makes it essential that the Commission plan for payment requirements over the medium and long-term. As well as meeting the cashflow requirements arising from the outstanding budgetary commitments future budgets will need to fund payments to meet liabilities recorded in the Union's balance sheet <sup>(48)</sup>. Together these represent a future need for disbursements amounting to around 313 billion euro at 31 December 2012.

1.59. The Court is of the opinion that the Commission should prepare and publish a long-range cashflow forecast, projecting future payment requirements, to assist in identifying future needs, planning budgetary priorities, and ensuring that necessary payments can be met from approved annual budgets. This analysis should consider the extent to which the EU will need to make pre-financing payments as well as meeting future disbursement needs arising from liabilities already recorded in the Union's balance sheet.

## THE COMMISSION'S REPLIES

**1.58.** *The outstanding commitments are thoroughly analysed by the Commission. The new legislative proposals made by the Commission for 2014-2020 aimed at strengthening the financial discipline, with an automatic de-commitment rule after 2 years of the yearly commitment. Moreover the Commission proposed to drop the exemptions for major projects. However in the inter-institutional process it appears that the co-legislators agree to expand the automatic decommitment rule to 3 years. Within the multiannual financial framework, the Commission is also proposing greater flexibility on budgetary management in order to transfer the unused margins within each heading to the following year.*

**1.59.** *The Commission already engages in very careful forward planning. However, the only way to resolve the outstanding commitments (RAL) is either to decommit or to pay. Decommitments are strictly determined by the financial rules, and would not be applicable in most cases. Therefore, the Commission is bound to pay the outstanding amounts.*

*The Commission will analyse how a long-range cash flow forecast, which includes also liabilities already recorded in the Union's balance sheet, can be best prepared and disclosed.*

<sup>(48)</sup> With the notable exception of loans given, most of the liabilities on the balance sheet will eventually turn into a demand for payment from the budget. Of the 137 billion euro liabilities which do not reflect borrowings, only 42 billion euro is already covered by commitments.



## ANNEX 1.1

## AUDIT APPROACH AND METHODOLOGY

1. The Court's audit approach is set out in the Financial and Compliance Audit Manual (FCAM). This manual is available on the Court's website. In order to plan audit work, and determine the extent of substantive testing, the Court uses an **audit assurance model**. This involves considering the risk of errors occurring in transactions (inherent risk) and the risk that the supervisory and control systems do not prevent or detect and correct such errors (control risk).

**PART 1 — Audit approach and methodology for the reliability of accounts (financial audit)**

2. In order to assess whether the consolidated accounts (the consolidated financial statements and the aggregated reports on the implementation of the budget) properly present, in all material respects, the financial position of the European Union, and the revenues, expenses and cashflows at the year end, the audit involves the following key elements:

- (a) evaluation of the accounting control environment;
- (b) checking of the functioning of key accounting procedures and the year end closure process;
- (c) analytical checks (consistency and reasonableness) on the main accounting data;
- (d) analyses and reconciliations of accounts and/or balances; and
- (e) substantive tests of commitments, payments and specific balance sheet items based on representative samples.

**PART 2 — Audit approach and methodology for the regularity of transactions (compliance audit)**

3. The approach taken by the Court to audit the regularity of the transactions underlying the accounts comprises:

- direct testing of transactions in each revenue or spending area (see **Tables 1.1** and **1.2**) in order to ascertain how far they are regular; and
- an assessment of the effectiveness of selected supervisory and control systems in ensuring the regularity of transactions. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of information and assurances from the Commission.

*How the Court tests transactions*

4. The direct testing of transactions within each specific assessment (chapters 2 to 9) is based on a **representative sample** of the receipts (in the case of revenue) and transactions contained within the policy group concerned <sup>(1)</sup>. This testing provides an estimate of the extent to which the transactions in the population concerned are irregular.

5. Transaction testing involves an **examination** of each transaction selected, to determine whether or not the claim or payment was made for the purposes approved by the budget and the legal basis, correctly calculated and in compliance with the relevant rules and regulations. This involves tracing the transaction down from the budgetary accounts to the level of the final recipient (e.g. farmer, organiser of training course, or development aid project promoter) and testing compliance at each level. When the transaction (at any level) is incorrectly calculated or does not meet a regulatory requirement or contractual provision, it is considered to contain an **error**.

<sup>(1)</sup> Additionally to this, a horizontal representative sample of commitments is drawn and tested for compliance with the relevant rules and regulations.

6. For expenditure the Court examines interim and final payments and clearing of advances ('expensed payments'). In other words it examines transactions at a point when the final recipients of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) have undertaken activities or incurred costs, and when the Commission has accepted that the activities undertaken or costs incurred justified payment from the EU budget. The Court thus looks at the economic reality underlying the transactions in EU's consolidated accounts.

7. The Court's audit sample is designed to provide an estimate of the level of error in the audited population as a whole. The Court does not examine transactions in every Member State, beneficiary state and/or region each year. The examples provided in the annual report are for illustrative purposes and demonstrate the most typical errors found. The naming of certain Member States, beneficiary states and/or regions does not mean that the examples presented cannot occur elsewhere. The illustrative examples presented in this report do not form a basis for conclusions to be drawn on the Member States, beneficiary states and/or regions concerned <sup>(2)</sup>.

*How the Court evaluates and presents the results of transaction testing*

8. **Errors** in transactions occur for a variety of reasons and take a number of different forms depending on the nature of the breach and specific rule or contractual requirement not followed. Individual transactions may be wholly or partially affected by error. Errors detected and corrected before and independently of the checks carried out by the Court are excluded from the calculation and frequency of error, since they demonstrate that the supervisory and control systems work effectively. The Court considers whether individual errors are quantifiable or non-quantifiable, depending on whether it is possible to measure how much of the amount audited was affected by error. In addition, the Court analyses the nature of errors detected, in particular distinguishing between eligibility (payment does not meet the eligibility rules), occurrence (reimbursement of a cost which is not proven to have been incurred) or accuracy (payment incorrectly calculated).

9. Many errors occur in the application of public procurement laws. To respect the basic principles of competition foreseen in the Treaty, contracts have to be advertised; bids must be evaluated according to specified criteria; contracts may not be artificially split to get below thresholds, etc.

10. For its audit purposes the Court puts a value on failures to observe the procedural requirements of procurement law. The Court:

- (a) regards as 'serious' those errors which frustrate the objectives of the public procurement rules: fair competition and award of the contract to the best qualified bidder <sup>(3)</sup>;
- (b) quantifies the impact of 'serious' infringements of the public procurement rules as affecting the entire value of the payment related to the contract — a 100 % quantifiable error <sup>(4)</sup>;
- (c) does not quantify or extrapolate less serious errors which do not affect the outcome of the tendering procedure (non-quantifiable errors <sup>(5)</sup>).

11. The quantification by the Court may differ from that used by the Commission or Member States when deciding how to respond to the misapplication of the public procurement rules.

<sup>(2)</sup> The aim of the audit is to reach a valid conclusion on EU expenditure and revenue as a whole. In order to make a valid, statistically significant, comparison among Member States, beneficiary states and/or regions, it would be necessary to sample a much larger number of transactions in each of them than is realistically possible.

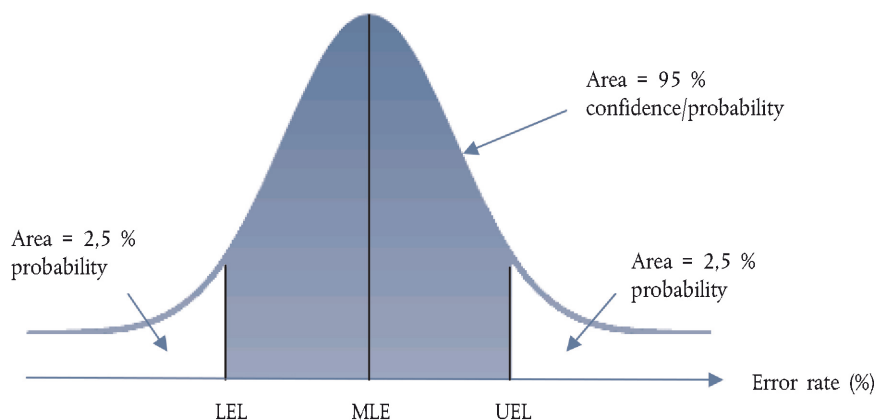
<sup>(3)</sup> There are essentially two award systems: the lowest offer or the most advantageous offer.

<sup>(4)</sup> Examples of a quantifiable error: no or restricted competition (except where this is explicitly allowed by the legal framework) for the main or a supplementary contract; inappropriate assessment of bids with an impact on the outcome of the tender; substantial change of the contract scope; artificial splitting of contracts in order to bring projects below the threshold at which public procurement rules apply.

<sup>(5)</sup> Examples of a non-quantifiable error: inappropriate assessment of bids without impact on the outcome of the tender, formal weaknesses of tender procedure or tender specification, formal aspects of the transparency requirements not respected.

*Estimated rate of error (most likely error)*

12. On the basis of the errors which it has quantified, the Court, estimates the **most likely rate of error** (MLE) <sup>(6)</sup> in each specific assessment, and for spending from the budget as whole. The MLE is a statistical estimate of the likely percentage of error (i.e. quantifiable breaches of applicable regulations, rules, and contract and grant conditions) in the population. The Court also estimates the lower error limit (LEL) and the upper error limit (UEL) (see illustration below).



13. The percentage of the shaded area below the curve indicates the probability that the true error rate of the population is between the LEL and the UEL.

14. In planning its audit work, the Court seeks to undertake procedures allowing it to compare the estimated rate of error in the population with a planning **materiality** of 2 %. In assessing audit results, the Court is guided by this level of materiality and takes account of the nature, amount and context of errors when forming its audit opinion.

*Frequency of error*

15. The Court expresses the frequency by which errors occur by presenting the proportion of the sample affected by either quantifiable or non-quantifiable errors.

*How the Court assesses systems and reports the results*

16. **Supervisory and control systems** are established by the Commission and Member States, beneficiary states and/or regions to manage the risks to the budget, including the regularity of transactions. Assessing the effectiveness of systems in ensuring regularity is therefore a key audit procedure, and particularly useful for identifying recommendations for improvement.

17. Each policy group is subject to a multitude of individual systems, as is revenue. The Court therefore normally assesses a sample of systems each year. The results of the **systems assessments** are presented in the form of a table called 'Results of examination of systems' given in Annexes X.2 of chapters 2 to 9. Systems are classified as being *effective* in mitigating the risk of error in transactions, *partially effective* (when there are some weaknesses affecting operational effectiveness) or *not effective* (when weaknesses are pervasive and thereby completely undermine operating effectiveness).

*How the Court arrives at its opinions in the Statement of Assurance*

18. The Court arrives at its opinion on the regularity of transactions underlying the European Union's consolidated accounts, set out in the Statement of Assurance, on the basis of all its audit work as reported in chapters 2 to 9 of this report and including an assessment of the pervasiveness of error. The work performed allows the Court to assess the assurance that errors in the population exceed or fall within the materiality limits. The Court's best estimate of the rate of error for overall spending in 2012 is 4,8 %. The Court has more than 95 % confidence that the rate of error for the audited population is material. The estimated error rate found in different policy areas varies as described in chapters 3 to 9. The Court assessed error as pervasive — extending across the majority of spending areas. The Court gives an overall opinion on the regularity of commitments based on an additional horizontal sample.

<sup>(6)</sup>  $MLE = \frac{1}{\sum ASI} * \sum_i \left( ASI_i * \frac{error\ amount_i}{audited\ amount_i} \right)$ , where ASI is the average sampling interval and *i* is the numbering of transactions in the sample.

*Irregularity or fraud*

19. The majority of errors arise from misapplication or misunderstanding of the often complex rules of EU expenditure schemes. If the Court has reason to suspect that fraudulent activity has taken place, it reports this to OLAF, the Union's antifraud office, which is responsible for carrying out any resulting investigations. The Court reports several cases per year to OLAF.

**PART 3 — Link between the audit opinions for the reliability of accounts and the regularity of transactions**

20. Pursuant to the provisions of Article 287 of the TFEU the Court has issued:

- (a) an audit opinion on the consolidated accounts of the European Union for the financial year ended; and
- (b) audit opinions on the regularity of the revenue, expensed payments and commitments underlying those accounts.

21. These audit opinions and the related audits are undertaken in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions.

22. These standards also provide for the situation where auditors issue audit opinions on the reliability of accounts and the regularity of transactions underlying those accounts, by stating that a modified opinion on the regularity of transactions does not in itself lead to a modified opinion on the reliability of accounts. The financial statements on which the Court places an opinion, in particular Note 6, recognise that there is a material issue in relation to breaches of the rules governing expenses charged to the EU budget. Accordingly, the Court has decided that the existence of a material level of error affecting regularity is not in itself a reason to modify its separate opinion on the reliability of the accounts.

## FOLLOW-UP OF OBSERVATIONS FROM PREVIOUS YEARS CONCERNING THE RELIABILITY OF ACCOUNTS

Observations raised in previous years	Court's analysis of the progress made	Commission reply
<b>1. Pre-financing, accounts payable and cut-off procedures</b>	<b>1. Pre-financing, accounts payable and cut-off procedures</b>	<b>1. Pre-financing, accounts payable and cut-off procedures</b>
<p>For pre-financings, accounts payable and related cut-off, since the financial year 2007 the Court has identified accounting errors with an immaterial financial impact overall but a high frequency. This underlines the need for further improvement at the level of certain directorates-general.</p> <p>As regards accounting for amounts pre-financed, the Court also identified:</p> <ul style="list-style-type: none"> <li>— that the clearing of outstanding pre-financings is not always carried out correctly. A number of clearings were either not carried out at all or for incorrect amounts,</li> <li>— that some directorates-general do not process the available information on progress made and related costs incurred and do not clear the corresponding pre-financing according to this progress, but use approximations when determining the cut-off,</li> <li>— for the first time in the 2010 annual report that in a growing number of cases the Commission has failed to properly record payments giving rise to an asset, in particular for financial engineering instruments and advances for other aid schemes.</li> </ul>	<p>The Court found that several directorates-general continue to record estimates in the accounts even when they have an adequate basis for clearing the corresponding pre-financings. In some cases, delays in accounting for expenditure incurred are linked to a loss of audit trail. The Court considers that significant improvements in procedures are required in certain directorates-general.</p> <p>The Commission included financial engineering instruments in the 2010 accounts and advances from other aid schemes in the 2011 accounts. Outstanding balances in both cases are estimated on the assumption that funds are used evenly over the period of operation. The Commission should keep this assumption under review.</p>	<p><i>The Commission is aware of the importance of this matter and is continuously working to improve its procedures. A specific article has been introduced in the revised Financial Regulation to encourage a more regular clearing of the pre-financings. These provisions are complemented by an interpretative guidance note which has been distributed to all Commission's directorates-general.</i></p> <p><i>The method described by the Court is applied since these particular items of expenditure have been identified. The Commission considers it unlikely that a different methodology, more reliable and at the same time cost-efficient, can be developed in the few months remaining of the current programming period.</i></p>

Observations raised in previous years	Court's analysis of the progress made	Commission reply
<b>2. Disclosures concerning recoveries and financial corrections</b>	<b>2. Disclosures concerning recoveries and financial corrections</b>	<b>2. Disclosures concerning recoveries and financial corrections</b>
<p>Financial reporting guidelines pertaining to what information is to be included and how it should be treated should be examined. Additional efforts are needed to improve the quality of the data presented.</p> <p>At year-end 2010 and 2011, for cohesion, a total amount of 2,5 billion euro still remained to be implemented (i.e. 'cashed' through the receipt of a repayment by the Commission or payment by the Commission on the basis of a claim from which the Member State has deducted ineligible expenditure). The low implementation rate of 71 % for 2010 and 72 % for 2011 was explained by the ongoing closure process for the programme period 2000-2006. Payment claims received end-2010 were not yet authorised, which meant that the related financial corrections could not be taken into account in the 2010 implementation figures.</p>	<p>The accounting officer has refined the presentation of information on recoveries and financial corrections in note 6. This note is now more focussed, and less extensive. Note 6 also contains non-financial information which could be better presented in the report on the protection of the EU budget according to Article 150(4) of the Financial Regulation (EU, Euratom) No 966/2012 to be presented to the budgetary authorities in September of each year.</p> <p>At the end of 2012, an amount of 1,1 billion euro remained to be implemented (implementation rate of 90 %). The total for 2012 included amounts of financial corrections that were part of the closure of 2000-2006 programmes (see box 1.1).</p>	<p><i>The Commission will continue its efforts to further improve the presentation of this information, noting that more detailed information will be presented in the Communication from the Commission on the protection of the EU budget.</i></p> <p><i>This figure is expected to increase during 2013 due to the closure of the ERDF 2000-2006 programmes. However for the Cohesion Fund, the regulatory provisions are different and the 2000-2006 Cohesion Fund projects will be closed mainly in the following year.</i></p>
<b>3. Transfer of assets of Galileo</b>	<b>3. Transfer of assets of Galileo</b>	<b>3. Transfer of assets of Galileo</b>
<p>The Commission should ensure that all the necessary accounting and technical information is available at the time when the transfer of the assets takes place in order to safeguard assets effectively.</p> <p>In its 2010 and subsequent annual reports, the Court has drawn attention to the reservation made by the responsible director-general in his annual activity report concerning the reliability of the European Space Agency's financial reporting.</p>	<p>The Commission is working with the European Space Agency to ensure that at the time of the transfer all the necessary accounting and technical information will be available.</p> <p>The responsible director-general maintained a reservation concerning the reliability of the financial reporting of the European Space Agency in his 2012 annual activity report.</p>	<p><i>The Commission has performed in-depth checks and has reasonable assurance that the amounts recognised on the balance sheet for Galileo are reliable. The preparations for the transfer of the assets are steadily advancing.</i></p> <p><i>The Commission will continue auditing the financial reports provided by ESA and correct errors if necessary. It will encourage and support ESA in further improving the quality of the financial reporting.</i></p>

## ANNEX 1.3

EXTRACTS FROM THE 2012 CONSOLIDATED ACCOUNTS <sup>(1)</sup>Table 1 — Balance sheet <sup>(\*)</sup>

	(million euro)	
	31.12.2012	31.12.2011
<b>Non-current assets</b>		
Intangible assets	188	149
Property, plant and equipment	5 978	5 071
Investments accounted for using the equity method	392	374
Financial assets	62 311	43 672
Receivables and recoverables	564	289
Long-term pre-financing	44 505	44 723
	<b>113 938</b>	<b>94 278</b>
<b>Current assets</b>		
Inventories	138	94
Financial assets	1 981	3 721
Receivables and recoverables	14 039	9 477
Pre-financing	13 238	11 007
Cash and cash equivalents	10 674	18 935
	<b>40 070</b>	<b>43 234</b>
<b>Total assets</b>	<b>154 008</b>	<b>137 512</b>
<b>Non-current liabilities</b>		
Pension and other employee benefits	(42 503)	(34 835)
Provisions	(1 258)	(1 495)
Financial liabilities	(57 232)	(41 179)
Other liabilities	(2 527)	(2 059)
	<b>(103 520)</b>	<b>(79 568)</b>
<b>Current liabilities</b>		
Provisions	(806)	(270)
Financial liabilities	(15)	(51)
Payables	(90 083)	(91 473)
	<b>(90 904)</b>	<b>(91 794)</b>
<b>Total liabilities</b>	<b>(194 424)</b>	<b>(171 362)</b>
<b>Net assets</b>	<b>(40 416)</b>	<b>(33 850)</b>
Reserves	4 061	3 608
Amounts to be called from Member States <sup>(**)</sup>	(44 477)	(37 458)
<b>Net assets</b>	<b>(40 416)</b>	<b>(33 850)</b>

(\*) The balance sheet is presented using the layout as in the consolidated accounts of the European Union.

(\*\*) The European Parliament has adopted a budget on 13 December 2012 which provides for the payment of the Union's short-term liabilities from own resources to be collected by, or called up from, the Member States in 2013. Additionally, under Article 83 of the Staff Regulations (Council Regulation (EEC, Euratom, ECSC) No 259/68 of 29 February 1968, as amended), the Member States shall jointly guarantee the liability for pensions.

<sup>(1)</sup> The reader is advised to consult the full text of the consolidated accounts of the European Union for the financial year 2012 including both the consolidated financial statements and explanatory notes and the aggregated reports on implementation of the budget and explanatory notes.

Table 2 — Statement of financial performance (\*)

	(million euro)	
	2012	2011
<b>Operating revenue</b>		
Own resource and contributions revenue	130 919	124 677
Other operating revenue	6 826	5 376
	<b>137 745</b>	<b>130 053</b>
<b>Operating expenses</b>		
Administrative expenses	(9 320)	(8 976)
Operating expenses	(124 633)	(123 778)
	<b>(133 953)</b>	<b>(132 754)</b>
<b>Surplus/(Deficit) from operating activities</b>	<b>3 792</b>	<b>(2 701)</b>
Financial revenue	2 157	1 491
Financial expenses	(1 942)	(1 355)
Movement in pension and other employee benefits liability	(8 846)	1 212
Share of net deficit of joint ventures and associates	(490)	(436)
<b>Economic result for the year</b>	<b>(5 329)</b>	<b>(1 789)</b>

(\*) The statement of financial performance is presented using the layout as in the consolidated accounts of the European Union.



Table 3 — Cashflow statement (\*)

	(million euro)	
	2012	2011
Economic result for the year	(5 329)	(1 789)
<b>Operating activities</b>		
Amortisation	39	33
Depreciation	405	361
(Increase)/decrease in loans	(16 062)	(27 692)
(Increase)/decrease in receivables and recoverables	(4 837)	1 605
(Increase)/decrease in pre-financing	(2 013)	(1 534)
(Increase)/decrease in inventories	(44)	(3)
Increase/(decrease) in provisions	299	234
Increase/(decrease) in financial liabilities	16 017	27 781
Increase/(decrease) in other liabilities	468	(45)
Increase/(decrease) in payables	(1 390)	6 944
Prior year budgetary surplus taken as non-cash revenue	(1 497)	(4 539)
Other non-cash movements	260	(75)
Increase/(decrease) in pension and employee benefits liability	7 668	(2 337)
<b>Investing activities</b>		
(Increase)/decrease in intangible assets and property, plant and equipment	(1 390)	(693)
(Increase)/decrease in investments accounted for using the equity method	(18)	118
(Increase)/decrease in available for sale financial assets	(837)	(1 497)
<b>Net cashflow</b>	<b>(8 261)</b>	<b>(3 128)</b>
Net increase/(decrease) in cash and cash equivalents	(8 261)	(3 128)
Cash and cash equivalents at the beginning of the year	18 935	22 063
Cash and cash equivalents at year end	10 674	18 935

(\*) The cashflow statement is presented using the layout as in the consolidated accounts of the European Union.

Table 4 — Statement of changes in net assets (\*)

(million euro)

	Reserves (A)		Amounts to be called from Member States (B)		Net Assets = (A) + (B)
	Fair value reserve	Other reserves	Accumulated Surplus/(Deficit)	Economic result for the year	
<b>Balance as at 31 December 2010</b>	<b>(61)</b>	<b>3 545</b>	<b>(48 163)</b>	<b>17 232</b>	<b>(27 447)</b>
Movement in Guarantee Fund reserve		165	(165)		0
Fair value movements	(47)				(47)
Other		2	(30)		(28)
Allocation of the 2010 economic result		4	17 228	(17 232)	0
2010 budget result credited to Member States			(4 539)		(4 539)
Economic result for the year				(1 789)	(1 789)
<b>Balance as at 31 December 2011</b>	<b>(108)</b>	<b>3 716</b>	<b>(35 669)</b>	<b>(1 789)</b>	<b>(33 850)</b>
Movement in Guarantee Fund reserve		168	(168)		0
Fair value movements	258				258
Other		21	(19)		2
Allocation of the 2011 economic result		6	(1 795)	1 789	0
2011 budget result credited to Member States			(1 497)		(1 497)
Economic result for the year				(5 329)	(5 329)
<b>Balance as at 31 December 2012</b>	<b>150</b>	<b>3 911</b>	<b>(39 148)</b>	<b>(5 329)</b>	<b>(40 416)</b>

(\*) The statement of changes in net assets is presented using the layout as in the consolidated accounts of the European Union.

Table 5 — EU Budget result (\*)

(million euro)		
European Union	2012	2011
Revenue for the financial year	139 541	130 000
Payments against current year appropriations	(137 738)	(128 043)
Payment appropriations carried over to year N+1	(936)	(1 019)
Cancellation of unused payment appropriations carried over from year N-1	92	457
Exchange differences for the year	60	97
<b>Budget result (**)</b>	<b>1 019</b>	<b>1 492</b>

(\*) The EU budget result is presented using the layout as in the consolidated accounts of the European Union.

(\*\*) Of which EFTA result is (4) million euro in 2012 and (5) million euro in 2011.



## CHAPTER 2

**Revenue**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

2.1. This chapter presents the specific assessment of revenue, which comprises own resources and other revenue. Key information on revenue in 2012 is provided in **Table 2.1**.

Table 2.1 — Revenue — key information 2012

Type of revenue	Description	Revenue 2012	
		million euro	%
GNI-based own resources	GNI (gross national income)-based resources from the current financial year	97 856	70,1
Traditional own resources (TOR)	Customs duties and sugar levies	16 454	11,8
VAT-based own resources	VAT (value added tax)-based resources from the current financial year	14 648	10,5
Correction of budgetary imbalances	UK correction	– 74	– 0,1
Reduction of GNI-based contribution	Granted to the Netherlands and Sweden	2	0,0
	<b>TOTAL OWN RESOURCES</b>	<b>128 886</b>	<b>92,4</b>
Interest on late payments and fines		3 807	2,7
Contributions and refunds in connection with Union/Community agreements and programmes		2 928	2,1
Surpluses, balances and adjustments		2 041	1,5
Revenue accruing from persons working with the Institutions and other Union bodies		1 236	0,9
Revenue accruing from the administrative operation of the Institutions		612	0,4
Miscellaneous revenue		31	0,0
Borrowing and lending operations		0	0,0
	<b>TOTAL OTHER REVENUE</b>	<b>10 655</b>	<b>7,6</b>
<b>TOTAL REVENUE FOR THE YEAR</b>		<b>139 541</b>	<b>100,0</b>

Source: 2012 consolidated accounts of the European Union.

## THE COURT'S OBSERVATIONS

**Specific characteristics of revenue**

2.2. Own resources constitute by far the main source of financing of budgetary expenditure (92,4 %). There are three categories of own resources <sup>(1)</sup>: own resources derived from Member States' gross national income (GNI), traditional own resources (TOR) (customs duties collected on imports and sugar production charge) and own resources calculated on the basis of value added tax (VAT) collected by Member States.

2.3. The GNI-based own resources result from the application of a uniform rate to the Member States' GNI. The calculation of the Member States' contributions for the current financial year (97 856 million euro, 70,1 % of revenue) is based on forecast GNI data <sup>(2)</sup>. This data is subject to revision for at least four years, after which it becomes time-barred <sup>(3)</sup>. Revisions are taken into account for the calculation of Member States' GNI balances and adjustments <sup>(4)</sup> of previous years which also contribute to the annual revenue budget. The principal risk to regularity is that the underlying statistics either are not compiled in compliance with EU rules or are not processed according to these rules.

2.4. After taking into account the total of TOR, VAT-based own resources and other revenue, the GNI-based own resources are used to balance the EU budget. Any understatement (or overstatement) of GNI for particular Member States — while not affecting the overall GNI-based own resources — has the effect of increasing (or decreasing) the contributions from the other Member States, until the GNI data is corrected.

<sup>(1)</sup> Council Decision 2007/436/EC, Euratom of 7 June 2007 on the system of the European Communities' own resources (OJ L 163, 23.6.2007, p. 17) and Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (OJ L 130, 31.5.2000, p. 1), as last amended by Regulation (EC, Euratom) No 105/2009 (OJ L 36, 5.2.2009, p. 1).

<sup>(2)</sup> This data is agreed between the Commission and the Member States at the meeting of the Advisory Committee on Own Resources.

<sup>(3)</sup> Unless reservations are set (see paragraph 2.24).

<sup>(4)</sup> They may be positive or negative in each Member State. For 2012, net GNI balances and adjustments amounted to 284 million euro, 0,2 % of revenue (positive adjustments amounted to 952 million euro, 0,7 % of revenue, and negative adjustments amounted to 668 million euro, 0,5 % of revenue).

THE COURT'S OBSERVATIONS

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2.5. TOR are established and collected by the Member States. Three quarters of these amounts are paid to the EU budget (16 454 million euro, 11,8 % of revenue), the remaining quarter being retained to cover collection costs. Each Member State sends the Commission a monthly statement of established duties (the 'A accounts') and a quarterly statement of those established duties which are not included therein (the 'B accounts') <sup>(5)</sup>. The principal risks regarding TOR are the completeness, accuracy and timeliness of the duties made available to the Union.

2.6. The VAT-based own resources are contributions resulting from the application of a uniform rate to Member States' notionally harmonised VAT assessment bases (14 648 million euro, 10,5 % of revenue). The principal risks lie in the completeness and accuracy of the harmonised VAT assessment base provided by Member States and accuracy and timeliness of the Member States contributions.

2.7. The United Kingdom is granted a correction in respect of budgetary imbalances ('the UK correction') which involves a reduction in its payments of GNI-based own resources <sup>(6)</sup>. In addition, Germany, the Netherlands, Austria and Sweden benefit from a reduced call rate for VAT, and the Netherlands and Sweden have a gross reduction in their annual GNI contribution for the period 2007-2013 <sup>(7)</sup>. The principal risk is that the Commission makes an error in these calculations, notably in respect of the complex UK correction calculations.

2.8. The other revenue audited consists mainly of the surplus of the previous year's budget, contributions in connection with Union/Community agreements (including EFTA), interest on late payments and fines. The principal risks in respect of other revenue include the Commission's management of fines and errors in the calculation of contributions in connection with Union/Community agreements.

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<sup>(5)</sup> When duties or levies remain unpaid and no security has been provided, or they are covered by securities but have been challenged, Member States may suspend making these resources available by entering them in these separate accounts.

<sup>(6)</sup> Article 4 of Decision 2007/436/EC, Euratom. This reduction was approximately 4 billion euro in 2012. The 74 million euro referred to in **Table 2.1** represents the effect of exchange rate differences.

<sup>(7)</sup> Articles 2(4) and 2(5) of Decision 2007/436/EC, Euratom. The 2 million euro related to the GNI-based contribution in **Table 2.1** is the effect of exchange rate differences.



## THE COURT'S OBSERVATIONS

**Audit scope and approach**

2.9. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of revenue, the following specific points should be noted:

- (a) The audit involved an examination at Commission level of a sample of 55 recovery orders <sup>(8)</sup>. The sample is designed to be representative of the entire range of recovery orders within revenue.
- (b) The assessment of systems examined:
  - (i) the systems for GNI-based own resources <sup>(9)</sup> and VAT-based own resources at Commission level, and TOR at Commission and Member State level;
  - (ii) the Commission systems underlying the calculation of the UK correction (including an examination of the calculation of the definitive amount in respect of 2008);
  - (iii) the Commission's management of fines and penalties;
  - (iv) the Commission's internal control procedures covering the determination of the yearly contributions of EFTA countries belonging to EEA ('EFTA contributions');
  - (v) the Commission's management representations, in particular the annual activity reports for 2012 (AAR 2012) of the Directorate-General for Budget (DG Budget) and Eurostat.

*GNI-based own resources*

2.10. The assessment took as its starting point the agreed forecast GNI data for 2012 and then assessed the Commission's systems for processing this data in order to determine the amounts to be included in the final budgetary accounts. The Court thus examined the drawing-up of the EU budget and the correctness of the contributions by Member States based on these forecasts.

<sup>(8)</sup> A recovery order is the procedure by which the authorising officer (AO) registers a Commission entitlement in order to retrieve the amount which is due.

<sup>(9)</sup> The assessment of the verification of GNI data included visits in the five Member States with the largest contributions to GNI-based own resources: Germany, Spain, France, Italy and United Kingdom.

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THE COURT'S OBSERVATIONS

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2.11. The Court assessed the Commission's supervisory and control systems, which are intended to provide reasonable assurance that GNI-based own resources are correctly calculated and collected. The audit also covered the Commission's management of GNI reservations in 2012. The Court cannot provide a judgement on the quality of the data agreed upon between the Commission and the Member States.

2.12. However, the Court also assessed the effectiveness of the Commission's verification of GNI data <sup>(10)</sup> of the period 2002-2010, which was completed in January 2012. The review focussed on the years 2002 to 2007, for which the GNI data, together with those of 2008, became definitive in 2012 with no further possibility of modification for the calculation of adjustments to GNI-based own resources, except for the discrete elements covered by specific reservations (see paragraph 2.25). This work is also taken into account in assessing the Commission's supervisory and control systems.

*Traditional own resources*

2.13. The Court assessed supervisory and control systems in selected Member States (Belgium, Poland and Finland), which together contribute around 13 % to total TOR. It reviewed their accounting systems (A and B accounts) and examined the flow of TOR from establishment until declaration to the Commission in order to obtain reasonable assurance that the amounts recorded were accurate and complete. The audit included testing key controls relating to the reliability of data in the import declarations (preferential codes and country of origin), post-clearance audits and risk analysis and the granting of notification waivers at import stage in the Member States visited.

2.14. In addition, the Court assessed the supervisory and control systems at the Commission, including its inspections in Member States, the procedure for writing off irrecoverable amounts and the procedure for following up both its and the Court's previous findings.

2.15. The Court's audit of transactions underlying the accounts cannot cover undeclared imports or those that have escaped customs surveillance.

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<sup>(10)</sup> The Member States examined in descending order of GNI-based own resources contributions were Germany, France, United Kingdom, Italy, Spain, Netherlands, Belgium, Sweden, Poland and Austria.

THE COURT'S OBSERVATIONS

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*VAT-based own resources*

2.16. VAT-based own resources are derived from the VAT actually received by Member States and adjusted using macro-economic statistics and estimates ('the harmonised VAT assessment base'). The audit took as its starting point the harmonised VAT base prepared by the Member States and assessed the Commission's systems for processing the data in order to determine the amounts to be included in the final budgetary accounts. The Court thus examined the drawing-up of the EU budget and the correctness of the contributions by Member States.

2.17. The Court assessed the Commission's supervisory and control systems, which are intended to provide reasonable assurance that VAT-based own resources are correctly calculated and collected. The Court evaluated the Commission's work carried out in Member States on the verification of the harmonised VAT assessment base and its management of reservations. The audit did not directly test the statistics and data provided by Member States.

**REGULARITY OF TRANSACTIONS**

2.18. **Annex 2.1** contains a summary of the results of transaction testing. Out of the 55 transactions audited by the Court none was affected by error.

**GNI-based own resources**

2.19. The Court's audit did not find any error in the Commission's calculation of Member States' contributions and their payment, most of which are based on forecast GNI data for 2012. However, the Court's assessment showed deficiencies in the Commission's approach and verification process (see paragraphs 2.28 to 2.30). These deficiencies had no material impact on the GNI-based own resources recorded (see paragraph 2.30).

**Traditional own resources**

2.20. The Court found that, overall, the recovery orders raised by the Commission reflect the A accounts' statements sent by the Member States.

**VAT-based own resources**

2.21. The Court's audit did not find any error in the calculation of Member States' contributions and their payment.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Other revenue**

2.22. The Court's audit did not find errors in the calculations or payments of other revenue transactions. However, the Court's audit found administrative weaknesses in the Commission's procedures for calculating part of one EFTA state's contribution <sup>(11)</sup>.

**2.22.** The Commission services will review the administrative procedure to address the weakness identified by the Court with particular regard to the calculation of the retroactive participation of EEA/EFTA States for which more detailed instructions will be prepared, as necessary.

**EFFECTIVENESS OF SYSTEMS**

2.23. **Annex 2.2** contains a summary of the results of the Court's examination of supervisory and control systems.

**2.23.** The Commission does not agree with the Court as regards the partial effectiveness of its GNI checks in Member States, since these show no material changes required in Member States' GNI OR contributions.

**GNI-based own resources***Management of reservations*

2.24. A reservation <sup>(12)</sup> is a means by which a doubtful element in GNI data submitted by a Member State can be kept open for correction after the statutory time-limit of four years. The use of reservations is thus part of the internal control process. The Commission and Member States should endeavour to resolve doubtful elements as soon as possible <sup>(13)</sup>.

**2.24.** The lifting of reservations is a high priority for the Commission and the Member States. The state of play on reservations is reviewed in each meeting of the GNI Committee with a target of lifting all current reservations as soon as possible.

2.25. The Commission replaced all existing general reservations for the EU-25 Member States with 103 specific reservations <sup>(14)</sup>. The specific reservations cover the years 2002 to 2010 for the EU-15 Member States and the years 2004 to 2010 for the EU-10 Member States. In addition, although there is no provision for them in the Commission's procedures, six transversal specific reservations <sup>(15)</sup> were placed on EU-25 Member States. The Court found weaknesses in the Commission's verification of GNI data which also affect the management of reservations (see paragraphs 2.28(b), second and third indents, and 2.29).

**2.25.** Transversal reservations are used when an issue concerning the calculation of GNI exists, the resolution of which requires a detailed comparative analysis of the solutions adopted by Member States and may require agreement in the GNI Committee on conceptual aspects. The results of this comparative analysis might identify the need for changes in the calculation of GNI in order to ensure that GNI-based own resources contributions are determined correctly.

<sup>(11)</sup> The Court could not confirm the correctness of 8 million euro out of 240 million euro.

<sup>(12)</sup> Reservations can be general or specific. General reservations cover all elements of the GNI compilation. Specific reservations cover discrete elements of GNI (GNP until 2001, GNI thereafter).

<sup>(13)</sup> Same applies to VAT-based own resources.

<sup>(14)</sup> For Bulgaria and Romania in 2012 there were general reservations covering the years 2007 and 2008. In January 2013 these were lifted and replaced by eight specific reservations for Bulgaria and 11 specific reservations for Romania covering the years 2007 to 2010.

<sup>(15)</sup> These reservations are defined by the Commission as points notified to all Member States to enable Eurostat to make a comparison of the underlying compilation of data.

## THE COURT'S OBSERVATIONS

2.26. In 2012 none of these specific GNI reservations were lifted. In addition, at the end of 2012 there were still two specific GNP reservations <sup>(16)</sup> in place relating to the period 1995-2001. The situation by Member State is shown in **Table 2.2**. The Commission does not estimate the potential impact of the reservations.

2.27. The Commission set a general reservation on Greek GNI data for the year 2008, as that Member State could not meet the deadline of 22 September 2012 for the transmission to Eurostat. The year 2008 would otherwise have become definitive and could no longer have been corrected.

## THE COMMISSION'S REPLIES

**2.26.** *The Commission is continuing its cooperation with, including undertaking country missions to, the two countries that still have GNP reservations for the period 1995-2001 so that these reservations can be lifted.*

*As National Accounts is a complex system of checks and balances, the effect of individual components cannot be isolated so it is not possible to quantify accurately the potential impact of the reservations (often it is not easy to determine whether it will be positive or negative).*

<sup>(16)</sup> One reservation concerns Greece and the other the United Kingdom.

**Table 2.2 — Member States' specific GNI/GNP reservations as at 31 December 2012 <sup>(1)</sup>**

Member State	Number of reservations outstanding at 31.12.2012	Earliest year to which reservations apply
Belgium	3	2002
Bulgaria	0	n/a
Czech Republic	2	2004
Denmark	1	2002
Germany	2	2002
Estonia	2	2004
Ireland	1	2002
Greece	9	1995
Spain	3	2002
France	2	2002
Italy	3	2002
Cyprus	5	2004
Latvia	10	2004
Lithuania	2	2004
Luxembourg	2	2002
Hungary	10	2004
Malta	8	2004
Netherlands	4	2002
Austria	1	2002
Poland	11	2002
Portugal	3	2002
Romania	0	n/a
Slovenia	3	2004
Slovakia	2	2004
Finland	1	2002
Sweden	4	2002
United Kingdom	11	1995
<b>TOTAL</b>	<b>105</b>	

<sup>(1)</sup> The transversal specific reservations are not included in the table.

Source: European Court of Auditors.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Assessment of Commission's verification of GNI data*

2.28. The Court's examination of the effectiveness of the Commission's verification of GNI data for the closed years 2002 to 2007 finalised in 2012 found that:

(a) Eurostat did not plan and prioritise its work in an appropriate way, as the risks relating to Member States' compilation of GNI data were not appropriately assessed and the cost-benefit principle<sup>(17)</sup> was not properly applied in the selection of areas to be verified,

(b) Eurostat did not demonstrate a consistent verification approach because:

— weaknesses were found in the performance of direct verification. Eurostat selected areas to be analysed using different criteria which were not always documented and there was no evidence that Eurostat always verified checks made by the national statistical institutes on the input data used for estimating the selected components,

— no evidence was provided of criteria used to set country specific reservations in accordance with the cost-benefit principle,

— some transversal specific reservations were set inappropriately. For example, in the case of the reservation on treatment of cooperative dwellings where 14 Member States declared they did not have these transactions, and of the treatment of entities with little or no physical presence, where the expected impact on GNI is limited.

2.28.

(a) The Commission considers that it had a well-established risk-based procedure for planning and prioritising its work. Regarding the recently completed verification cycle, plans were presented to and agreed on by the GNI Committee. The GNI Regulation mainly foresees the information enabling (cost-benefit) judgment on the potential size and significance of specific activities or transactions to be qualitative. This corresponds to the approach chosen by the Commission in its verification work.

(b)

— Eurostat selected the components/areas to be verified by direct verification according to the general criteria agreed on in the GNI Committee (it was clearly stated *ex ante* that the selected components may differ from country to country). The scope of direct verification was foreseen to start when the data arrived at the national accounts department. In addition, the Member States were to provide documentation on any checks done by the national accounts department on the input data. The Commission will look into ways of improving the documentation.

— As in previous verification cycles, the reservations were set on the basis of a quantitative and qualitative assessment of each of the open points and taking budgetary prudence into account. After the draft country assessment reports have been accepted by the GNI Committee it is the prerogative of the Commission, as stipulated in the Own Resource Regulation, to set reservations without approval of the country concerned or the GNI Committee. Regarding the cost-benefit principle see reply to paragraph 2.28(a) above. The Commission is of the opinion that this approach is efficient in safeguarding the financial interests of the EU with respect to GNI Own Resources.

— The transversal issues called for a detailed comparative analysis of the solutions adopted by Member States. As of the end of 2012 the declarations of the Member States had not yet been verified. Now that this process is taking place the Commission will lift reservations in the Member States where appropriate.

<sup>(17)</sup> See Article 5(2)(b) of Council Regulation (EC, Euratom) No 1287/2003 of 15 July 2003 on the harmonisation of gross national income at market prices (GNI Regulation) (OJ L 181, 19.7.2003, p. 1).

## THE COURT'S OBSERVATIONS

2.29. The Court also found problems in the compilation of national accounts' estimates that had not been detected by Eurostat. Some of these problems<sup>(18)</sup> should have led to additional country specific reservations being placed by the Commission, whereas others<sup>(19)</sup> revealed an inconsistent setting of reservations between Member States.

2.30. Although this would not affect the calculation of GNI-based own resources for the financial year 2012, the individual contributions of Member States for the years 2002 to 2007 would have been different<sup>(20)</sup>.

**Traditional own resources**

2.31. In all Member States visited, the Court's audit (see paragraph 2.13) revealed deficiencies in national customs supervision related to post-clearance audits and risk analysis. Where national customs supervision is only partially effective, there is an increased risk that the amounts of TOR collected are inaccurate.

2.32. The system weaknesses identified in Belgium in the 2010 and 2011 annual reports are being addressed by the Commission together with the Member State. In DG Budget's AAR for 2012 there is a reservation on the reliability of the accounting data of this Member State.

2.33. Furthermore, in the other two Member States visited (Poland and Finland) the Court found other minor system weaknesses related to the A- and B-accounts.

## THE COMMISSION'S REPLIES

2.29. *The Commission is examining the Court's findings and will draw the appropriate conclusions thereon.*

2.30. *See reply to paragraph 2.29.*

2.31. *Taking into account the replies and arguments from the three Member States visited by the Court the Commission will follow up the deficiencies identified with those Member States and where appropriate it will request them to take the necessary remedial measures. It will continue to examine the national customs supervision in the course of its inspections and where weaknesses are found it will request the Member States to take measures to redress those weaknesses.*

2.32. *For the period 2008-2010, an external financial audit has been carried out in 2013 and its audit opinion stating that the accounts are free from material error was accepted by the Commission after an in-depth review of the audit conclusions and the underpinning audit tests performed.*

2.33. *Where weaknesses are confirmed in the management of the accounts by these Member States, they will be requested to take measures to address these weaknesses.*

<sup>(18)</sup> For example, in the classification and valuation of non-profit institutions serving households in Germany, Spain and France; in the estimation of the underground economy in Germany, Spain, France and Italy, of distribution margins in Germany and of renting services in France and Italy.

<sup>(19)</sup> For example, in the recording of EU grants and of rents on land.

<sup>(20)</sup> The scale of the potential impact of the quantifiable observations on the annual GNI contribution of the Member States visited ranged from +0,4 % to -1,1 %, but this assumes that no other changes would have been needed for GNI components in the five Member States concerned, or in the GNI estimates of the other 22 Member States. The weaknesses leading to the non-quantifiable observations may also affect the calculation of Member States' contributions. Overall, the differences found are neither material for GNI for 2002 to 2007 nor for 2012.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**VAT-based own resources**

2.34. In 2012, the Commission placed 54 reservations and lifted 57. According to the Commission, the net effect of the control activities in Member States where reservations were lifted was to decrease VAT-based own resources by approximately 4 million euro <sup>(21)</sup>. At the end of the year, a total of 153 reservations were in place (see **Table 2.3**). Of the reservations put in place by the Commission, 44 relate to infringements of VAT legislation. These can only be lifted after the infringement procedure has been closed and the effect on the VAT base for the years concerned has been determined. 17 reservations have been placed by the Member States themselves.

2.35. The Court defines long-outstanding VAT reservations as dating back to a year at least 10 years previously, i.e. those in place at the end of 2012 concerning 2003 and earlier. The overall situation is similar to previous years. There were 16 long-outstanding reservations at the year end, some dating back to 1995, compared to 15 at the end of 2011. Of the long-outstanding reservations five relate to infringements and three were placed by Member States.

2.35. The totals may be similar but during any period some long-outstanding reservations will have been lifted, while some newer reservations may now merit the description long-outstanding. Both happened during 2012. The five infringements referred to by the Court only became long-outstanding in 2012. They are part of a large collection of reservations arising from the same infringement. The Commission will not be in a position to lift these reservations in advance of a judgment from the European Court of Justice. Similarly, the Commission is not in a position to resolve the three reservations set by Member States. Of the remaining reservations outstanding at the end of 2012 five have since been lifted including one of the two Commission-set reservations which concerned 1995.

<sup>(21)</sup> The balance of an increase of 31 million euro and a decrease of 35 million euro.

Table 2.3 — VAT reservations as at 31 December 2012

Member State	Reservations outstanding at 31.12.2011	Reservations placed in 2012	Reservations lifted in 2012	Reservations outstanding at 31.12.2012	Earliest year to which reservations apply
Belgium	1	5	0	6	2007
Bulgaria	6	2	1	7	2007
Czech Republic	13	2	7	8	2004
Denmark	8	1	3	6	2005
Germany	6	2	1	7	2003
Estonia	10	0	0	10	2004
Ireland	5	0	1	4	2006
Greece	7	0	2	5	1999
Spain	3	0	0	3	2003
France	7	11	6	12	2005
Italy	7	5	0	12	1995
Cyprus	4	0	4	0	n/a
Latvia	5	0	0	5	2004
Lithuania	2	5	5	2	2008
Luxembourg	0	2	0	2	2008
Hungary	4	3	3	4	2004
Malta	10	2	8	4	2005
Netherlands	9	2	0	11	2004
Austria	6	4	5	5	2004
Poland	5	7	2	10	2004
Portugal	5	0	0	5	2003
Romania	4	0	0	4	2007
Slovenia	0	0	0	0	n/a
Slovakia	0	1	1	0	n/a
Finland	10	0	2	8	1995
Sweden	11	0	6	5	1995
United Kingdom	8	0	0	8	1998
<b>TOTAL</b>	<b>156</b>	<b>54</b>	<b>57</b>	<b>153</b>	

Source: European Court of Auditors.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Fines and penalties**

2.36. At the end of 2012 around 98 % of fines <sup>(22)</sup> pending were covered either by a provisional payment or by a guarantee. The Financial Regulation's implementing rules <sup>(23)</sup> state that the Commission should enforce the recovery of amounts receivable by any available means where neither provisional payment has been made nor guarantees lodged by debtors to cover the full amount by the due date.

2.37. The Court examined a sample of 30 fines which were not covered either by a provisional payment or by a guarantee and found that in 12 cases the Commission had not used all available means to enforce the recovery. The Court reported on the same issue in its 2011 annual report <sup>(24)</sup>.

**Annual activity reports**

2.38. DG Budget states in its annual activity report for 2012 that it has reasonable assurance as to the accuracy and completeness of the GNI data used for own resources purposes because of the opinion given by the GNI Committee and the results of verification activities undertaken by Eurostat. The Court considers that there is a limitation to the scope of the GNI Committee opinion <sup>(25)</sup> and that Eurostat's AAR provides only a partial assessment of the verifications carried out on GNI data for own resources purposes. DG Budget's AAR should have referred to these limitations.

**2.36.** *The objective of the Commission is not to enforce recovery at any price because this could have irreparable consequences for the fined undertakings. Most of the pending fines have a provisional character since they have been appealed and may be cancelled or reduced. Therefore the Commission seeks to obtain coverage through a negotiated payment plan covered by a financial guarantee, or in exceptional circumstances under the new rules of application without a financial guarantee.*

**2.37.** *These fines concern either cases where interim measures or inability to pay requests were pending, and/or cases where enforcement would have caused the immediate insolvency of the fined undertaking, with the consequence that the Commission would have lost the fine because it is not a preferential creditor under the current rules.*

**2.38.** *The absence of opinion regarding the GNI data of Romania and Bulgaria did not prevent the use of the data for own resource purposes, given that corrective mechanisms are in place permitting any necessary future modifications.*

<sup>(22)</sup> About 10,8 billion out of 11 billion euro.

<sup>(23)</sup> Articles 84, 85 and 85a of Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002, p. 1), as last amended by Regulation (EC, Euratom) No 478/2007 (OJ L 111, 28.4.2007, p. 13).

<sup>(24)</sup> See paragraphs 2.29 to 2.31 in the 2011 annual report.

<sup>(25)</sup> For 2012 the GNI Committee stated that it cannot yet form an opinion on the GNI data of Bulgaria and Romania as the verification is still ongoing.

## THE COURT'S OBSERVATIONS

2.39. Following the ruling of the European Court of Justice <sup>(26)</sup>, in which it declared Commission Regulation (EC) No 1193/2009 <sup>(27)</sup> invalid, the Commission calculated an amount of 285,5 million euro to be reimbursed to sugar producers <sup>(28)</sup> of which the Commission would pay 214 million euro to Member States. The Court considers that this major event should have been mentioned in the annual activity report of DG Budget.

## THE COMMISSION'S REPLIES

**2.39.** *The Commission does not consider that mentioning this in the AAR is needed as the budgetary risk was duly flagged. Commission Regulation (EC) No 1193/2009 fixing the production levies in the sugar sector for marketing years 2002/2003, 2003/2004, 2004/2005, 2005/2006 is a management measure for agricultural markets. However since sugar levies are traditional own resources, the invalidation of the regulation raised a budget execution risk for own resources that was duly covered by a provision in the provisional annual accounts for 2012. The € 214 million provision covers the amount of sugar levies that Member States are likely to get back on the basis of a revised draft regulation setting lower levies.*

## CONCLUSIONS AND RECOMMENDATIONS

## Conclusions for revenue 2012

2.40. Based on its audit work, the Court concludes that, for the year ended 31 December 2012:

- testing of transactions indicates that the most likely error rate present in the population is nil,
- the examined supervisory and control systems are overall effective for GNI-based own resources and for TOR (see **Annex 2.2**),
- the examined supervisory and control systems are effective for VAT-based own resources, the calculation of the UK correction, and other revenue (see **Annex 2.2**).

Overall audit evidence indicates that revenue is not affected by a material level of error.

2.41. Supervisory and control systems for GNI-based own resources were assessed as overall effective in ensuring that the transactions underlying revenue are legal and regular, except for the Commission's verification of GNI data which was considered to be partially effective because:

**2.41.**

<sup>(26)</sup> Ruling of 27 September 2012 for joined cases C- 113/10, C- 147/10 and C-234/10.

<sup>(27)</sup> Commission Regulation (EC) No 1193/2009 of 3 November 2009 correcting Regulations (EC) No 1762/2003, (EC) No 1775/2004, (EC) No 1686/2005, (EC) No 164/2007 and fixing the production levies in the sugar sector for marketing years 2002/2003, 2003/2004, 2004/2005, 2005/2006 (OJ L 321, 8.12.2009, p. 1).

<sup>(28)</sup> Marketing years 2002/2003 to 2005/2006.

## THE COURT'S OBSERVATIONS

- Eurostat does not plan and prioritise its work in an appropriate way and does not apply a consistent approach between Member States (paragraph 2.28);
- there were also problems in the compilation of national accounts' estimates that had not been detected by Eurostat (paragraphs 2.29 to 2.30).

2.42. The Court also draws attention to the matters set out below:

- (a) There are weaknesses in the Commission's management of reservations for GNI-based own resources. Additional country specific reservations should have been placed and some reservations were set inconsistently between Member States (paragraph 2.25). In addition, the Commission had not yet lifted the two remaining specific GNP reservations for the period 1995 to 2001 (paragraph 2.26).
- (b) Long-outstanding reservations exist in connection with VAT-based own resources (paragraph 2.35).
- (c) The Court's audit revealed weaknesses in national customs supervision (paragraphs 2.31 to 2.33). The Court concludes that the supervisory and control systems of the Member States audited are only partially effective in ensuring that the TOR recorded are complete and correct.

## THE COMMISSION'S REPLIES

- *The Commission has a well-established procedure for planning and prioritising its work agreed, according to the GNI Regulation, by the GNI Committee. Please refer to the response regarding paragraph 2.28.*
- *It is the Commission's opinion that its procedures are the most cost-effective method given the nature of the GNI Own Resource. However, the Commission will take the Court's findings into account when setting the standards for the next verification cycle which will start in 2015.*

*Please refer to the response regarding paragraphs 2.29 and 2.30.*

**2.42.**

- (a) *The Member States subject to GNI reservations are required to transmit to the Commission by 22 September 2014 the changes needed to (plus explanations of the changes made on) GNI estimates as a result of the points notified, or any additional methodological information showing clearly that the items notified are no longer relevant.*
- (b) *Concerning the consistency of the setting of reservations, please refer to the replies regarding paragraph 2.29.*

*Please also refer to the response regarding paragraphs 2.25 and 2.26.*

*In addition to the subsequent lifting of five long-outstanding reservations commented on in response to paragraph 2.35, action has been continuing with the Member States concerned to lift more reservations. Solution strategies have been identified and are in progress for a further two.*

## THE COURT'S OBSERVATIONS

**Recommendations**

2.43. **Annex 2.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented six recommendations. Out of these recommendations, the Commission fully implemented two recommendations, while one was implemented in most respects, two were implemented in some respects and one was not implemented.

2.44. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission:

- **Recommendation 1:** reviews its control framework for the verification of GNI data including carrying out a structured and formalised cost-benefit analysis, carrying out in-depth verification of material and risky GNI components, limiting the use of general reservations and setting materiality criteria for placing reservations;

## THE COMMISSION'S REPLIES

**2.43.** The supervisory and control systems (SCS) are of an organisational nature and give no specific indication of the reliability of the accounts, which depends primarily on the statistical sources and methods used, even though SCS may help mitigate the risks of errors in national accounts. The Commission will pursue its efforts to develop SCS guidelines for compilation of their national accounts by Member States, taking into account the observations made by the Court. (re. 2010/2009, item 2 of Annex 2.3)

As regular Commission inspections confirm the B account is computerised in most of the Member States the number of amounts unduly declared in the B account is diminishing. Most of the Commission findings in their inspections of the B account concern the financial responsibility of the Member States stemming from unsatisfactory recovery procedures or administrative errors and do not directly relate to the management of the account itself. (re. 2010/2009, item 3 of Annex 2.3).

The Commission has presented a thematic report on local clearance procedures, consolidating the results of inspections carried out in almost all the Member States, to the Advisory Committee on Own Resources and to the Customs Policy Group in 2012 highlighting the key areas where further action is necessary. It will continue to examine the remedial action taken by the Member States until the deficiencies have been addressed. (re. 2010/2009, item 4 of Annex 2.3)

Both the Commission and Member States have taken action to implement the recommendation. Of the 20 long-outstanding reservations giving rise to the Court's recommendation in 2009, 17 have been resolved and lifted. For the remaining three, Court action is required before one can be lifted and strategies are in place to resolve the other two. (re. 2009 of Annex 2.3)

**2.44.**

In preparation of the next verification cycle, starting in 2015, the Commission will review its control framework. In that process it will take into consideration the points raised by the Court.

## THE COURT'S OBSERVATIONS

- **Recommendation 2:** encourages Member States to strengthen customs supervision in order to maximise the amount of TOR collected;
- **Recommendation 3:** encourages Member States to correctly use A and B accounts and to ensure that they are demonstrably complete and correct.

## THE COMMISSION'S REPLIES

*The Commission in the course of its regular TOR inspections will continue to verify that the Member States have put in place appropriate control frameworks to protect the financial interests of the EU in the area of traditional own resources.*

*The Commission will continue to examine the use of the A and B accounts in the course of its inspections and will request the Member States to ensure that they are complete and correct.*

## ANNEX 2.1

## RESULTS OF TRANSACTION TESTING FOR REVENUE

2012				2011	2010	2009
TOR	VAT/GNI, corrections under budget Title 1	Other revenue	Total			

## SIZE AND STRUCTURE OF THE SAMPLE

Total transactions:	5	47	3	55	55	55	62
Recovery orders	5	47	3	55	55	55	62

RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>

## Proportion (number) of transactions tested found to be:

Free of error	100 %	(5)	100 %	(47)	100 %	(3)	100 %	(55)	98 %	100 %	95 %
Affected by one or more errors	0 %	(0)	0 %	(0)	0 %	(0)	0 %	(0)	2 %	0 %	5 %

## ESTIMATED IMPACT OF QUANTIFIABLE ERRORS

Most likely error rate	0 %
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<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments. The results of testing reflect the proportionate share each segment has within the policy group.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.



## ANNEX 2.2

## RESULTS OF THE EXAMINATION OF SYSTEMS FOR REVENUE

## Assessment of the systems examined

System concerned	Commission checks in Member States	Commission calculation/desk checks and revenue management	Commission management of reservations	Key internal controls in Member States visited	Overall assessment
GNI	Partially effective (*)	Effective	Effective	N/A	Effective
VAT	Effective	Effective	Effective	N/A	Effective
TOR	Effective	Effective	N/A	Partially effective (**)	Effective
UK correction	N/A	Effective	N/A	N/A	Effective
Fines and penalties	N/A	Effective	N/A	N/A	Effective

(\*) See paragraphs 2.28 to 2.30.

(\*\*) See paragraphs 2.31 to 2.33.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR REVENUE

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	The Court recommended in its 2010 and 2009 annual reports that the Commission should:							
	Present to the GNI Comittee the assessment reports on GNI data of Member States so as to be able to replace in 2012 all existing general reservations with specific reservations for the period 2002 onwards.	The Comission already presented to the GNI Committee the draft assessment reports and replaced the general reservations by the specific reservations (the draft assesment reports were presented in 2011 for the EU-25 Member States and in 2012 for Bulgaria and Romania and the general reservations were replaced by the specific ones in January 2012 and January 2013, respectively).						

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010 and 2009	Make clear the scope of the opinion it provides in its assessment reports on Member States GNI data.	In the two reports the Commission presented to the GNI Committee in 2012 (Bulgaria and Romania) the Commission made an assessment on the quality of GNI data and on its conformity with ESA95, clarifying the objectives and identifying the verifications carried-out to support the overall conclusion.						
	Take into account an evaluation of supervisory and control systems in the national statistical institutes (NSI) for the compilation of national accounts.				In 2012 Eurostat had not adopted guidelines setting out best practices on the functioning of supervisory control systems for the compilation of national accounts.			See reply to paragraph 2.43.
	Continue its efforts to ensure that B accounts are correctly used by Member States.		Although the Commission follows-up the use of B accounts every year, the problem persists.					See reply to paragraph 2.43.
	Continue its efforts to ensure that national customs supervision (e.g. granting of the 'super simplification' for users of local clearance procedures) is further strenghtened.			In December 2012 the Commission presented a report on its follow-up of the local clearance procedure in Member States. Conclusions of the report indicate that the national customs supervision needs further improvement.				See reply to paragraph 2.43.

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2009	Continue to press the Member States to provide quickly adequate information which would enable it to lift long-outstanding reservations as soon as possible.			There were 16 long-outstanding reservations at the end of 2012 compared to 20 in 2009.				See reply to paragraph 2.43.

## CHAPTER 3

**Agriculture: market and direct support**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

3.1. This chapter presents the specific assessment of market and direct support for agriculture, which is part of policy area 'Agriculture and rural development'. Key information on the activities covered and the spending in 2012 is provided in **Table 3.1**.

**Table 3.1 — Market and direct support for agriculture — Key information 2012**

(million euro)

Policy area	Description	Payments	Management mode
Agriculture expenditure financed by the EAGF	Direct aid	40 880	Shared
	Interventions in agricultural markets	3 516	Shared <sup>(1)</sup>
	Administrative expenditure <sup>(2)</sup>	133	Centralised direct
	Other	149	Centralised direct/Shared
		<b>44 678</b>	
Total payments for the year		<b>44 678</b>	
– total administrative expenditure <sup>(3)</sup>		133	
Total operational expenditure		<b>44 545</b>	
– advances <sup>(4)</sup>		17	
+ clearings of advances		18	
<b>Audited population, total</b>		<b>44 546</b>	
<b>Total commitments for the year</b>		<b>44 685</b>	

<sup>(1)</sup> This figure includes 0,7 million euro under centralised management.

<sup>(2)</sup> This amount represents the total administrative expenditure for policy area agriculture and rural development.

<sup>(3)</sup> The audit of administrative expenditure is reported in chapter 9.

<sup>(4)</sup> In line with the harmonised definition of underlying transactions (for details see chapter 1, paragraphs 1.6 and 1.7).

Source: 2012 consolidated accounts of the European Union.

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group**

3.2. The objectives <sup>(1)</sup> of the common agricultural policy (CAP) as set out in the Treaty are to increase agricultural productivity, thus to ensure a fair standard of living for the agricultural community, to stabilise markets, to assure the availability of supplies and to ensure that supplies reach consumers at reasonable prices.

3.3. The EU budget finances CAP expenditure mainly through two funds <sup>(2)</sup>: the European Agricultural Guarantee Fund (EAGF), which fully finances EU direct aid and market measures <sup>(3)</sup>, and the European Agricultural Fund for Rural Development (EAFRD), which co-finances rural development programmes together with the Member States. This chapter covers EAGF while EAFRD is presented in chapter 4.

3.4. The main measures financed by EAGF are:

- The *direct aid* 'Single Payment Scheme' (SPS) providing payments based on 'entitlements' <sup>(4)</sup> each of which is activated with one hectare of eligible land. In 2012 SPS represented 31 081 million euro of expenditure.
- The *direct aid* 'Single Area Payment Scheme' (SAPS), a simplified income support scheme directed at farmers in 10 of the Member States <sup>(5)</sup> which joined the EU in 2004 and 2007 and which provides for the payment of uniform amounts per eligible hectare of agricultural land. In 2012 SAPS accounted for 5 916 million euro of expenditure.
- Other *direct aid* schemes providing mainly coupled payments <sup>(6)</sup>. In 2012, those schemes accounted for 3 883 million euro of expenditure.
- *Interventions in agricultural markets* covering for example intervention storage, export refunds, food aid programmes and specific support for the fruit/vegetable and the wine sectors (in total amounting to 3 516 million euro in 2012).

<sup>(1)</sup> Article 39 of the Treaty on the Functioning of the European Union (TFEU).

<sup>(2)</sup> Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005, p. 1).

<sup>(3)</sup> With the exception of certain measures such as promotion measures and the school fruit scheme, which are co-financed.

<sup>(4)</sup> The number and value of each farmer's entitlements are calculated by the national authorities according to one of the models provided for under EU legislation.

<sup>(5)</sup> Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.

<sup>(6)</sup> Coupled aid payments are payments which are calculated on the basis of number of animals and/or number of hectares cultivated with a specific crop (e.g. suckler cows, cotton, rice, etc.).

## THE COURT'S OBSERVATIONS

3.5. Under all EAGF direct aid schemes, beneficiaries of EU aid have a legal obligation <sup>(7)</sup> to fulfil cross-compliance requirements. These requirements relate to the protection of the environment, public health, animal and plant health, animal welfare (Statutory Management Requirements (SMRs)) and to the maintenance of agricultural land in good agricultural and environmental condition (GAEC) <sup>(8)</sup>. If farmers do not comply with these obligations their aid is reduced <sup>(9)</sup>.

3.6. CAP expenditure is subject to shared management. While responsibility for the legality and regularity of spending starts in the Member States <sup>(10)</sup>, the Commission bears the ultimate responsibility for the correct implementation of the budget. Expenditure is channelled through 81 paying agencies responsible for making payments to the beneficiaries. Prior to making payments, they must, either directly or through delegated bodies, check the eligibility of the aid applications. The Integrated Administration and Control System (IACS) is the main management and control system to ensure the regularity of EAGF direct aid payments. The accounts and payment records of the paying agencies are examined by independent audit bodies (certification bodies) which submit annual certificates and reports to the Commission.

3.7. The Commission has to obtain assurance that the Member States have set up management and control systems in accordance with EU requirements and that these systems function effectively.

3.8. The main risks to the regularity of direct payments are that area aid is paid for ineligible land, to ineligible beneficiaries, to more than one beneficiary for the same plot of land, that entitlements are calculated incorrectly and that animal premia are paid for ineligible animals. For interventions in agricultural markets the main risks to regularity are that aid is granted for ineligible or overstated costs.

## THE COMMISSION'S REPLIES

**3.5.** *The respect of cross-compliance obligations does not constitute an eligibility criterion for CAP payments and, therefore, the controls of these requirements do not pertain to the legality and regularity of the underlying transactions. Cross-compliance is a mechanism by which farmers are penalised when they do not respect a series of rules which stem in general from other policies than the CAP and apply to EU citizens independently of the CAP. Thus, the Commission considers that penalties imposed for violations of cross-compliance requirements should not be taken into account for the calculation of the error rates for the CAP.*

**3.6. and 3.7.** *According to Article 5 of Commission Regulation (EC) No 885/2006, the Certification Bodies examine on an annual basis not only annual accounts of the paying agencies, but also their internal control procedures.*

**3.8.** *The Commission concurs with the Court on the main risks for the first pillar of the CAP.*

*For direct payments the whole IACS is designed in a way to mitigate these risks. The Commission targets these risks during its own audits.*

<sup>(7)</sup> Articles 4 to 6 of Council Regulation (EC) No 73/2009 (OJ L 30, 31.1.2009, p. 16).

<sup>(8)</sup> Whilst GAEC standards, as referred to in Annex III of Regulation (EC) No 73/2009, apply in all Member States, SMRs as referred to in Annex II of that regulation are mandatory only in EU-15. For the EU-10, SMRs are being phased in between 2009 and 2013, and for EU-2 between 2012 and 2016.

<sup>(9)</sup> According to Articles 70 and 71 of Commission Regulation (EC) No 1122/2009 (OJ L 316, 2.12.2009, p. 65), the level of the reduction per SMR or GAEC obligation not complied with can vary between 1 % and 5 % in case of negligence and can lead to full rejection of the aid in case of intentional non-compliance.

<sup>(10)</sup> Articles 3 and 9 of Regulation (EC) No 1290/2005.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Audit scope and approach**

3.9. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of market and direct support for agriculture the following specific points should be noted:

- the audit involved an examination of a sample of 180 transactions <sup>(11)</sup> as defined in **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of transactions within the policy group. In 2012 the sample consisted of transactions from 16 Member States <sup>(12)</sup>,
- the audit covered cross-compliance requirements (selected GAEC obligations <sup>(13)</sup> and SMR 4 <sup>(14)</sup>). Cases where cross-compliance obligations were not met were treated as errors <sup>(15)</sup> provided that it could be established that the infringement already existed in the year in which the farmer applied for aid <sup>(16)</sup>. In addition, the Court examined the implementation of cross-compliance standards and controls by Member States in the context of its EAFRD systems audits. The results of this work are presented in chapter 4 (paragraph 4.24) but are also applicable to this chapter,

3.9. See replies to paragraphs 1.11 and 1.12 on the impact of recoveries and financial corrections on the protection of the financial interests of the EU.

- The Commission is closely following the developments of the Court's DAS methodology in view of any potential impact on the error rate.
- See reply to paragraph 3.5.

<sup>(11)</sup> In order to provide additional insight into the non-IACS component of the population, the sample was stratified and comprised 140 IACS transactions and 40 non-IACS transactions.

<sup>(12)</sup> Czech Republic, Denmark, Germany, Ireland, Greece, Spain, France, Italy, Latvia, Luxembourg, Hungary, Austria, Poland, Portugal, Romania and the United Kingdom.

<sup>(13)</sup> Avoiding the encroachment of unwanted vegetation, retention of terraces, maintenance of olive groves and respect of minimum livestock stocking rates or mowing obligations.

<sup>(14)</sup> SMR 4 relating to Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources (OJ L 375, 31.12.1991, p. 1).

<sup>(15)</sup> Cross-compliance obligations are substantive legal requirements that must be met by all recipients of EU direct aid. They are the basic and in many cases the only conditions to be respected in order to justify the payment of the full amount of direct aid, hence the Court's decision to treat cross-compliance infringements as errors.

<sup>(16)</sup> For each infringement, the national system for reduction of payments has been used for the quantification of the error. See also footnote 9.

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THE COURT'S OBSERVATIONS

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- reductions and exclusions (to be applied by Member States in cases where beneficiaries of EU aid over-claim the actual area or number of animals <sup>(17)</sup>) are not included in the Court's error rate calculation <sup>(18)</sup>,
- the assessment of systems examined IACS in three paying agencies <sup>(19)</sup>, in two Member States applying the SPS — Luxembourg and the United Kingdom (Northern Ireland and England) — and the supervisory and control systems applicable to the EU food aid scheme for the most deprived persons <sup>(20)</sup> in Spain and Italy,
- the audit included a review of the annual activity report of the Commission's Directorate-General for Agriculture and Rural Development (DG AGRI) concerning EAGF-related issues,
- the Court reviewed DG AGRI's clearance of accounts audit work and visited the certification bodies of Luxembourg and the United Kingdom (Northern Ireland). The results of this work, which also apply to this chapter, are presented in chapter 4 (see paragraphs 4.26 to 4.36).

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<sup>(17)</sup> Regulation (EC) No 1122/2009 provides that, where the claimed area is found to be overstated by more than 3 % or two hectares, the aid amount shall be calculated on the basis of the area determined reduced by twice the area claimed irregularly. If the difference is more than 20 % no aid shall be granted for the crop group concerned. Similar provisions apply to animal premia.

<sup>(18)</sup> Except in cases where Member States had already found the irregularity without applying the due reductions/exclusions.

<sup>(19)</sup> The paying agencies and key controls were selected on the basis of a risk analysis.

<sup>(20)</sup> Article 43 of Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) (OJ L 299, 16.11.2007, p. 1).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**REGULARITY OF TRANSACTIONS**

3.10. **Annex 3.1** contains a summary of the results of transaction testing. Out of the 180 transactions audited by the Court 74 (41 %) were affected by error. On the basis of the errors which it had quantified, the Court estimates the most likely error to be 3,8 % <sup>(21)</sup>.

3.11. For a significant number of transactions affected by error, the Court considers that the national authorities had enough information to detect and correct the errors concerned.

3.12. Of the 74 transactions affected by errors 60 were affected by quantifiable errors, concerning accuracy or eligibility of aid payments. The most frequent accuracy errors relate to over-declarations of land and to administrative errors, most of which amount individually to less than 5 %. Area over-declaration cases were found in 11 of the 16 Member States visited. Most administrative errors related to incorrect values of entitlements (see box 3.1).

3.13. The larger accuracy errors relate mostly to excessive payments for permanent pasture for which cross-checks of declared parcels with the Land Parcel Identification System (LPIS) failed to detect over-declarations because ineligible land was recorded as eligible permanent pasture in the LPIS database (see box 3.1).

**3.10.** While this is the error rate estimated by the ECA, it does not necessarily represent the actual risk for the EU budget. For instance, it is noted that non-respect of procurement rules does not necessarily imply that the whole expenditure has been misused.

The Commission notes that the lower error limit estimated by the Court is below the materiality threshold.

**3.11.** The Commission also considers that the legal and technical tools (notably the Integrated Administration and Control Systems) provided to the Member States by the CAP legislation for managing and controlling the expenditure allow the Member States to detect and correct most of the errors.

However, as clearly disclosed in its AAR for 2012, DG AGRI's audits indicate that in a number of Member States significant weaknesses exist in the management and control systems. These findings are the basis for conformity clearance procedures with a view to adequately shielding the EU budget from risk of irregular payment and, on average around 600 million EUR is clawed back to the budget each year for the EAGF.

**3.12.** The Commission notes that most of the quantifiable errors are relatively small in financial terms and mainly concern small differences in the re-measurement of parcels carried out by the Court; indeed, 36 of the errors found by the Court are less than 5 % of which 23 are below 2 %.

Where errors in relation to incorrect values of entitlements create a risk to the Fund, these are followed up in the conformity clearance procedure. For the incorrect calculation of entitlements for France referred to in box 3.1, clearance procedures covering both financial years 2011 and 2012 are ongoing.

**3.13.** The Commission is aware of the issue and is following up the issue through its clearance of accounts procedure and, when necessary, through an action plan.

<sup>(21)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,7 % and 5,9 % (the lower and upper error limits respectively).

## THE COURT'S OBSERVATIONS

**Box 3.1 — Examples of accuracy errors****Overdeclarations — Claiming aid for ineligible land**

In Spain, Austria and Portugal some reference parcels claimed and paid for as permanent pasture were in reality fully or partly covered with rocks, dense forests or bushes, which should exclude them from EU aid <sup>(22)</sup>. Aid claims for these parcels were accepted because their real status was not properly reflected in the LPIS. In some of the cases the parcels may have been used for an agricultural activity in the past, but were found to have been abandoned for years.

**Incorrect calculation of payment entitlements recorded in the entitlement database**

In France SPS aid payments audited were incorrect due to non-compliance with the national ceiling for allocated entitlements fixed by the EU legislation <sup>(23)</sup>.

Incorrect entitlement calculations were also found in Luxembourg (see paragraph 3.23).

## THE COMMISSION'S REPLIES

**Box 3.1 — Examples of accuracy errors****Overdeclarations — Claiming aid for ineligible land**

*The ongoing conformity clearance procedures will cover the risks in relation to all three Member States mentioned by the Court.*

*As regards the eligibility of pasture areas in Spain, the National Authorities were requested to act on this matter and presented the LPIS Improvement Plan in November 2010. This improvement plan includes notably measures to implement the application of an eligibility coefficient to pasture parcels and to ensure systematic update of LPIS with the results of on-the-spot checks. The Commission monitors the implementation of this plan as part of the conformity clearance, via which the corresponding risk for the Fund will be covered.*

*As regards Portugal, the shortcoming was subject to an action plan which was completed in 2013. For the years concerned, the risk for the Fund is subject to a conformity clearance procedure.*

**Incorrect calculation of payment entitlements recorded in the entitlement database**

*In relation to the incorrect calculation of payments entitlements in France, conformity clearance procedures covering FY2011 and FY2012 are ongoing. France has been requested to correct the value of the entitlements without any unnecessary delay. The Commission observes that its conformity procedure for the incorrectness of the payment entitlements in France was launched as a follow-up to the DAS 2011 exercise and that this error is clearly confined to France. The exact amount of the undue payments for the overall population will be determined and fully recovered via the conformity procedure. The Commission estimates that this ceiling overshoot represents 0,2 percentage points of the overall error rate established by the Court.*

*The observation concerning Luxembourg will be followed up via the conformity clearance procedure.*

<sup>(22)</sup> EU legislation defines permanent pasture as land used to grow grasses or other herbaceous forage traditionally found in natural pastures.

<sup>(23)</sup> The Court referred to this issue already in its 2011 annual report, box 3.2.

## THE COURT'S OBSERVATIONS

3.14. The systematic weaknesses detected concerning the correct assessment of the eligibility of permanent pasture have already been reported in previous annual reports <sup>(24)</sup> and were also found in the context of the systems audits carried out in the United Kingdom (England and Northern Ireland).

3.15. As regards eligibility errors the Court has identified cases where the costs declared were not eligible (see box 3.2).

**Box 3.2 — Example of eligibility errors — Ineligible staff costs**

In Portugal salaries of staff of the regional authorities in charge of carrying out on-the-spot inspections were claimed by these authorities as technical assistance, contrary to the EU legislation <sup>(25)</sup>.

3.16. On the basis of its examination of selected cross-compliance obligations (see paragraph 3.9, second indent) the Court found infringements in 24 <sup>(26)</sup> of the 146 payments subject to these obligations <sup>(27)</sup>. The most frequent cross-compliance infringements observed relate to land not maintained in GAEC and inadequate or insufficient storage facilities for nitrates of animal origin.

## THE COMMISSION'S REPLIES

**3.14.** *The Commission is aware of the issues related to the eligibility of pasture areas in this Member State and the matter is being followed up via the conformity clearance procedure.*

**Box 3.2 — Example of eligibility errors — Ineligible staff costs**

*This issue will be followed up in the framework of the conformity clearance procedure.*

**3.16.** *Concerning the most frequent infringements found by the Court, the Commission pays particular attention to the definition and implementation of GAEC standards and SMR4 (storage facilities for nitrates of animal origin) during its cross-compliance audits. Any weaknesses observed are being followed up via the conformity clearance procedure.*

<sup>(24)</sup> 2007 annual report, table in Annex 5.1.2 for Portugal; 2008 annual report, paragraph 5.36 for Spain; 2009 annual report, paragraph 3.38 for Spain and Italy; 2010 annual report, Table 3.2.1 for Spain; 2011 annual report, paragraph 3.20 and Table 3.2 for Spain, Italy and Austria.

<sup>(25)</sup> Article 13 of Regulation (EC) No 1290/2005.

<sup>(26)</sup> 13 of the 24 cases affected the payment audited, while the remaining 11 cases only affect future payments.

<sup>(27)</sup> The infringements observed account for 0,2 percentage points of the error rate presented by the Court in paragraph 3.10.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**EFFECTIVENESS OF SYSTEMS****Member States' systems related to regularity of transactions**

3.17. **Annex 3.2** contains a summary of the results of the Court's examination of supervisory and control systems <sup>(28)</sup>.

**3.17.** Under the shared management system it is the responsibility of the paying agencies' internal control system to reveal deficiencies. That means that ongoing monitoring system and internal audit of the paying agency should detect in the first place if the administrative and control procedures are not effective. The annual certification carried out by the Certification Bodies for the clearance of accounts includes the review of compliance with accreditation criteria. Very often the paying agency is aware of the deficiencies and is taking actions to remedy the weaknesses, which takes time. The conformity clearance procedure is in place to ensure that financial corrections can be applied against Member States for financial errors due to weak controls or for non-compliance with key controls.

*The Integrated Administration and Control System (IACS)*

3.18. IACS covers the main schemes financed by EAGF, i.e. SPS and SAPS as well as all area-related coupled aid schemes and animal premium schemes. The system consists of databases of farm holdings and aid applications, a Land Parcel Identification System (LPIS), animal databases and a database of entitlements in the Member States implementing the SPS. The system provides for several eligibility checks including cross-checks between databases and on-the-spot inspections.

3.19. The assessment of IACS covered compliance with the provisions of the relevant regulations and an assessment of the effectiveness of the systems in ensuring the legality and regularity of payments, notably the following elements:

- (a) administrative and control procedures and quality of databases;
- (b) control systems based on physical on-the-spot checks;
- (c) procedures to ensure recovery of undue payments.

<sup>(28)</sup> Findings related to the IACS, except those concerning entitlements, apply also to area-related and animal-related rural development measures.

## THE COURT'S OBSERVATIONS

3.20. The Court's audits show that the effectiveness of IACS is adversely affected, mainly by inaccurate databases used for cross-checks.

**Administrative and control procedures and quality of databases**

3.21. The administrative and control procedures <sup>(29)</sup> applied by paying agencies must include cross-checks wherever possible and appropriate, inter alia with all IACS databases. The Court verified whether databases hold complete and reliable information, whether cross-checks identified anomalies and whether corrective action was taken where necessary.

3.22. The LPIS is a database which contains a record of the entire agricultural area (reference parcels) of a Member State and the respective eligible areas of every reference parcel. The LPIS is based on a Geographical Information System (GIS) containing digitised and geo-referenced parcel boundaries, which should preferably be based on spatial orthoimagery <sup>(30)</sup>. The eligible areas of reference parcels are to be assessed on the basis of the most recent orthoimages. The Court found significant deficiencies in the LPIS audited (see box 3.3).

## THE COMMISSION'S REPLIES

**3.20.** *The Commission services are attentive to the accuracy of the information in the data bases, as it is a key element for the correct management and control. When deficiencies are found, Member States are requested to remedy them. Furthermore, the risk for the Fund is covered under the conformity clearance procedure.*

*Whilst recognising that there will inevitably always remain certain weaknesses and imperfections, the Commission services are however of the opinion that IACS as a whole remains a solid system for management of CAP expenditure.*

<sup>(29)</sup> Articles 28 and 29 of Regulation (EC) No 1122/2009.

<sup>(30)</sup> Orthoimages are aerial photographs used to assess the eligibility of land in the LPIS.



## THE COURT'S OBSERVATIONS

**Box 3.3 — Examples of incorrect data in LPIS/GIS**

In the United Kingdom (England) the paying agency does not assess the eligibility of common land (329 000 ha) and makes only limited use of ortho-images for assessing the eligibility of other parcels claimed. The Court reviewed a risk-based sample of forest parcels and found that some had benefited from EU aid, contrary to EU legislation.

In the United Kingdom (Northern Ireland) ineligible features are not displayed as ineligible land in the GIS. An LPIS update was carried out in 2011 in order to remedy the weaknesses detected during the quality assessment required by EU legislation <sup>(31)</sup>. The Court reviewed a limited risk-based sample of reference parcels which according to the ortho-images were forests and found that several of these parcels were recorded as permanent pasture. For some other parcels the eligible area recorded in the LPIS was found to be bigger than the total area of the parcel.

3.23. With regard to the accuracy of payments, the Court found deficiencies in all three paying agencies. In Luxembourg funds available in the national reserve were used to increase the value of all allocated entitlements, contrary to the provisions <sup>(32)</sup> of EU legislation. In the United Kingdom (England and Northern Ireland) the Court observed several cases where the aid amount was calculated on the basis of areas larger than those actually determined by on-the-spot checks carried out by national inspectors.

**Control systems based on physical on-the-spot checks**

3.24. The quality of the on-the-spot measurements is of key importance for the correct determination of aid amounts. The Court has re-performed a number of measurements carried out by the three paying agencies audited. In all three the Court's measurements differed by more than applicable tolerance margins <sup>(33)</sup> from the results reported by paying agency inspectors (in Luxembourg for 5 out of 61, in the United Kingdom (Northern Ireland) for 6 out of 42 and in the United Kingdom (England) for 8 out of 21 measurements).

## THE COMMISSION'S REPLIES

**Box 3.3 — Examples of incorrect data in LPIS/GIS**

Presently, there is no legal obligation for the use of ortho-images. However, the Commission has proposed in the horizontal regulation dealing with control, financing and monitoring of the CAP, that MS would be required to use such imagery.

If audits show that information in the system is wrong and this has created a risk, this is followed up under the conformity clearance procedure.

As regards the situation in Northern Ireland, the update activities carried out by the authorities in 2011 were a result of audits carried out by the Commission services in the years 2006-2009. These have led to financial corrections for the years until 2009. Conformity clearance procedures are still underway in respect of the subsequent years.

3.23. The situation with regard to Luxembourg will be followed up via the conformity clearance procedure.

The situation with regard to the UK (England and Northern Ireland) is and will be followed up through many conformity clearance procedures.

3.24. The Commission services share the view of the Court that the quality of on-the-spot checks is important. Audits carried out by the Commission services have identified similar deficiencies in the quality of the on-the-spot checks and the weaknesses found are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered.

The Commission's audits have also identified the IACS deficiencies in England and Northern Ireland. These paying agencies have already been subject to financial corrections in this regard and further conformity clearance procedures are ongoing.

<sup>(31)</sup> Article 6(2) of Regulation (EC) No 1122/2009 provides an obligation for Member States to carry out an annual quality assessment of their LPIS.

<sup>(32)</sup> Article 41 of Regulation (EC) No 73/2009.

<sup>(33)</sup> Article 34(1) of Regulation (EC) No 1122/2009.



## THE COURT'S OBSERVATIONS

3.25. EU legislation defines grassland as land covered with herbaceous vegetation. In the United Kingdom (England and Northern Ireland) SPS aid is granted for grazeable woodlands. However, when the Court re-performed on-the-spot inspections in the United Kingdom (England) several such parcels were found to contain no grass and therefore did not meet the definition of grazeable woodlands. National inspectors had reported the areas to be fully eligible for EU aid.

#### Procedures to ensure recovery of undue payments

3.26. In the three paying agencies selected for an IACS systems audit the Court examined the accounting records to establish whether the amounts to be recovered are properly accounted for and whether these amounts are correctly reported to the Commission. In Luxembourg and the United Kingdom (England) such procedures were found to operate satisfactorily.

3.27. In the United Kingdom (Northern Ireland) the Court observed that reconciliation of the amounts recorded in the debtor's ledger to the underlying individual records was not always possible and accrued interests were not recorded in the table of undue payments.

#### *Control systems applicable to the EU food aid scheme for the most deprived persons*

3.28. The Court examined the control systems applicable to the EU food aid scheme for the most deprived persons in Spain and Italy. Under the scheme, the successful tenderer undertakes to provide a certain quantity of food to charities for distribution to the most deprived persons <sup>(34)</sup> in the EU. In many cases, the tenderer is paid in the form of goods delivered from intervention stocks. Very often, these goods come from intervention storage facilities in a Member State other than that where the food is distributed. In these cases the food aid scheme requires close administrative cooperation between the Member States involved.

3.29. In both paying agencies examined, the Court assessed the systems applicable to the distribution of food to be effective. However, the Court found that administrative cooperation between the Member States concerned was affected by certain deficiencies (see **Annex 3.2**).

## THE COMMISSION'S REPLIES

**3.25.** The Commission services are aware of the problems identified by the Court and are following them up — see box 3.3.

The Commission services are of the view that, for example, to enable maintenance of agriculture in specific areas, the Member States can implement a procedure which ensures that the eligible area within these parcels is considered for payment, in so far that overall the parcel can still be considered as 'agricultural'. Guidelines including examples on how to assess the area to be taken into account have been discussed with and distributed to the Member States over the recent years.

**3.27.** The Commission is aware of the situation and is following it up in the context of the clearance of accounts procedure.

**3.29.** The Commission takes note of the Court's overall positive assessment.

<sup>(34)</sup> The term 'Most deprived persons' is defined in Article 1(3) of Commission Regulation (EU) No 807/2010 of 14 September 2010 laying down detailed rules for the supply of food from intervention stocks for the benefit of the most deprived persons in the Union (OJ L 242, 15.9.2010, p. 9).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Commission's estimates of the residual error rate**

3.30. DG AGRI assesses the Residual Error Rate (RER), i.e. the extent to which transactions remain affected by error after the operation of the supervisory and control systems. Before AAR 2012, the basic elements for this assessment were the on-the-spot inspection statistics compiled by the Member States. DG AGRI based the calculation of the residual error rate on the results of randomly selected inspections reported in the statistics. In order to compensate for any potential deficiencies or incompleteness of these statistics DG AGRI applied a 25 % uplift to the error rate reported in the statistics.

3.31. In its AAR 2012 and following an assessment of the reliability of the procedures applied, DG AGRI made a substantial revision of its approach to calculating the residual error rate. It now takes into account the fact that the inspection statistics can be affected by deficiencies impacting their reliability and that they do not cover all components of the residual error rate. Consequently, DG AGRI has carried out an individual assessment for every paying agency and has corrected upwards the reported error rates when deemed necessary. Uplifts of 2 or 5 percentage points depending on the severity of weaknesses were made for 37 out of 81 paying agencies.

3.32. As a result, the residual error rate for decoupled area aid for 2012 is calculated by the Commission to be 2,4 %, i.e. 4,5 times higher than the error rate of 0,54 % <sup>(35)</sup> calculated on the basis of the statistics reported by the Member States.

3.33. This change of approach recognises the weaknesses reported by the Court in previous annual reports <sup>(36)</sup> and confirmed by the Commission's Internal Audit Service <sup>(37)</sup>. However, the Court considers that the Commission should also take corrective action for the remaining areas of EAGF.

**3.30.** *The way DG AGRI established the residual error rate reported in its annual activity report for 2012 is described in paragraph 3.31. The description in paragraph 3.30 on how this was done in previous years is out-of-the audit scope of this report.*

**3.31.** *In previous years the Court has criticised DG AGRI for basing the residual error rate only on the basis of data reported by the Member States on the controls which they have carried out with a safety margin of 25 %. For the year 2012 DG AGRI has developed and used for the decoupled direct payments (SAPS and SPS) a new integrated approach applied at paying agency level which is still based on the control statistics from the Member States, but which also takes into account other available audit evidence such as the opinion of the Certification Bodies, the result of audits by the Commission and the assessment by the Court on the effectiveness of the control system. Available information from ECA audits, Certification Bodies findings and Commission's own audits is integrated in an overall assessment of the situation at Paying Agency level and taken into account when aggregating at MS and EU-27 level.*

**3.32.** *As reported in the DG AGRI AAR 2012, conformity clearance procedures are ongoing for the 17 Member States affected by an error rate higher than 2 %. The amounts at risk will systematically be recovered.*

**3.33.** *The new integrated approach which was used for 2012 for decoupled direct aids will be further developed and extended as much as possible to the other CAP measures for the year 2013.*

<sup>(35)</sup> EU-27 weighted average of error rates reported by the Member States for the decoupled area aid inspection statistics.

<sup>(36)</sup> Most recently in the 2011 annual report, paragraph 3.41.

<sup>(37)</sup> Paragraph 3.1.5 of DG AGRI AAR 2012.

## THE COURT'S OBSERVATIONS

3.34. The results of the new approach confirm that only limited assurance can be gained from the Member States' inspection statistics, the declarations of the directors of paying agencies and from the work carried out by the certification bodies. Indeed, for all 37 paying agencies for which the Commission decided to apply an uplift to the decoupled area aid error rate reported in the control statistics, the directors of the respective paying agencies had given an unqualified opinion and for 32 of them the certification bodies had also done so.

## CONCLUSION AND RECOMMENDATIONS

## The conclusion for 2012

3.35. For this policy group:

- testing of transactions indicates that the most likely error present in the population is 3,8 %;
- of the three IACS supervisory and control systems examined <sup>(38)</sup>, two were assessed as not effective (United Kingdom (England and Northern Ireland)) and the other was assessed as partially effective (Luxembourg);
- the two examined supervisory and control systems applicable to the distribution of food to the most deprived persons were assessed as effective.

Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

## THE COMMISSION'S REPLIES

3.34. See reply to paragraph 3.32.

*The work of the Certification Bodies will be greatly expanded in the framework of the implementation of the CAP reform: they will have to re-perform on a representative sample the administrative and on-the-spot controls done by the paying agency in order to give an opinion on the legality and regularity of the transactions underlying the expenditure and thus validate of the control statistics.*

3.35. See reply to paragraphs 1.12 and 1.13 on the impact of recoveries and financial corrections on the protections of the financial interests of the EU.

- *The Commission services have in their own audits evidenced similar findings to those of the Court. These are followed up via the conformity clearance procedure. Where the findings of the Court would evidence a further risk to be covered instigation of appropriate procedures will be considered.*

*The Commission underlines that it safeguards the financial interest of the EU budget via financial corrections in the framework of the conformity clearance procedure. In addition, shortcomings in Member States' management and control systems are addressed through targeted and comprehensive action plans where necessary. The Commission also notes that the lower error limit estimated by the Court is below the materiality threshold.*

<sup>(38)</sup> All examined IACS systems were selected on the basis of a risk analysis.

## THE COURT'S OBSERVATIONS

**Recommendations**

3.36. **Annex 3.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented seven recommendations. Out of these recommendations, two were implemented in most respects, four were implemented in some respects and one was not implemented.

3.37. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission and Member States increase and speed up their efforts to ensure that:

- **Recommendation 1:** the eligibility of land, and in particular permanent pasture is properly recorded in the LPIS, especially in cases where areas are fully or partly covered with rocks, shrubs or dense trees or bushes or where land has been abandoned for several years (see paragraphs 3.13, 3.25 and box 3.3);

## THE COMMISSION'S REPLIES

**3.36.** The Commission has a different view of the status of implementation of the recommendations made in previous annual reports:

- 'implementation in most respects': the Commission considers that implementation of these points is continuous and could never be considered complete (the use of ortho-photos becoming mandatory, LPIS updated on the basis of new ortho-photos and remedying of deficiencies in control systems and IACS databases);
- 'implementation in some respects': Ensuring that the on-the-spot checks are of sufficient quality and that this is checked by the Certification Bodies is a continuous process;
- clarifying the rules for eligibility: the Commission has made proposals in the context of the CAP reform, while the guidelines for the work to be performed by the CBs have been thoroughly reviewed and presented to the Member States and CBs;
- set at EU level minimum annual maintenance requirements for grasslands: the CAP reform proposals provide for this to be done by the Member States.

**3.37.**

To enable maintenance of agriculture in specific areas, the Member States can implement a procedure which ensures that the eligible area within these parcels is considered for payment, in so far that overall the parcel can still be considered as 'agricultural'. Guidelines including examples on how to assess the area to be taken into account have been discussed with and distributed to the Member States over the recent years.

Where it is found that the Member State fails to correctly record eligible area the case is subject to a clearance procedure.

## THE COURT'S OBSERVATIONS

- **Recommendation 2:** immediate remedial action is taken where administrative and control systems and/or IACS databases are found to be deficient or out of date (see paragraphs 3.13 and 3.22 to 3.23);
- **Recommendation 3:** payments are based on inspection results (see paragraph 3.23) and that on-the-spot inspections are of the quality necessary to determine the eligible area in a reliable manner (see paragraphs 3.24 and 3.25);
- **Recommendation 4:** the design and quality of the work performed by the directors of paying agencies and the certification bodies in support of their respective declarations and statements provide a reliable basis for the assessment of the legality and regularity of underlying transactions (see paragraphs 3.30 to 3.34).

## THE COMMISSION'S REPLIES

*When the Commission services detect such problems during the course of their audits, they request the Member State to take remedial actions. Where the problem is particularly acute, the Member State is required to implement a remedial action plan which is closely followed by the services. So far such plans have been found to be very effective. The Commission also ensures that the financial risk to the EU budget arising from such deficiencies is covered via financial corrections imposed via the conformity clearance procedure.*

*The Commission shares the view of the Court in this regard and it will continue to focus its audits on the risk of ineligible land being not detected prior to the payments. Financial corrections will be applied where necessary to protect the EU financial interests.*

*The Commission continues to review the work of the Certification Bodies via the analysis of the documents related to the financial clearance of accounts as well as audit missions to Certification Bodies. In addition, in 2012, specific audit missions were conducted at 14 Certification Bodies to review their work on on-the-spot controls and control statistics, because these fields were identified by the Commission to be particular risks. In September 2012, a Certification Bodies' expert group meeting was organised. Furthermore, in preparation to the new programming period, and in line with the increased responsibility of Certification Bodies to cover legality and regularity of expenditure, bilateral meetings are organised with Certification Bodies in 2013.*

## ANNEX 3.1

## RESULTS OF TRANSACTION TESTING FOR AGRICULTURE: MARKET AND DIRECT SUPPORT

	2012			2011	2010	2009
	IACS	Non-IACS	Total			
SIZE AND STRUCTURE OF THE SAMPLE						
Total transactions:	140	40	180	180	146	148
RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>						
Proportion (number) of transactions tested found to be:						
Free of error	60 % (84)	55 % (22)	59 % (106)	61 %	73 %	76 %
Affected by one or more errors	40 % (56)	45 % (18)	41 % (74)	39 %	27 %	24 %
Analysis of transactions affected by error						
Analysis by type of error						
Non-quantifiable errors:	14 % (8)	33 % (6)	19 % (14)	14 %	26 %	31 %
Quantifiable errors:	86 % (48)	67 % (12)	81 % (60)	86 %	74 %	69 %
Eligibility	12 % (6)	67 % (8)	23 % (14)	23 %	3 %	13 %
Occurrence	0 % (0)	0 % (0)	0 % (0)	2 %	0 %	0 %
Accuracy	88 % (42)	33 % (4)	77 % (46)	75 %	97 %	87 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate	3,8 %					
Upper error limit (UEL)	5,9 %					
Lower error limit (LEL)	1,7 %					

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 3.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR AGRICULTURE: MARKET AND DIRECT SUPPORT

## Assessment of selected supervisory and control systems — EAGF

Member State (Paying agency)	Scheme	IACS related expenditure (national ceiling, Annex VIII to Regulation (EC) No 73/2009) (1 000 euro)	Administrative and control procedures to ensure correct payment including quality of databases	On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results	Procedures for the recovery of undue payments	Overall assessment (*)
UK (England)	SPS	3 988 042	Not effective 1, 2, 5, 6, 7, 8, 9	Partially effective a	Partially effective A	Not effective
UK (Northern Ireland)	SPS	3 988 042	Not effective 1, 3, 5, 6, 9, 10	Partially effective a	Partially effective A, B	Not effective
Luxembourg	SPS	37 679	Partially effective 2, 4	Effective	Effective	Partially effective

(\*) The overall assessment cannot be any better than the assessment of the administrative and control procedures.

- 1 Incomplete or incorrect information on size and eligibility of land in the LPIS database.
- 2 Claim registration procedure does not have sufficient built-in controls to prevent the date of arrival being backdated.
- 3 Errors in claims were corrected as obvious errors without application of penalties when those should have been applied.
- 4 Values of entitlements were increased contrary to EU legislation.
- 5 Incorrect application of the EU definition of farmer.
- 6 Aid payments made for ineligible areas.
- 7 Inconsistencies in the entitlements database.
- 8 Non application of sanctions for areas claimed incorrectly on common land.
- 9 Inspection results not correctly processed in the IACS databases.
- 10 Deficiencies in administrative cross-checks and aid payments made before clearance of anomalies.

a Insufficient quality of area measurements during on-the-spot checks.

A Inaccuracies in the debtors accounts.

B Delays in recording debts and notifying farmers of repayment obligations.

Member State (Paying agency)	Scheme	Expenditure (*) (1 000 euro)	Procurement procedures	Cooperation with other Member States	Implementation of the plan	Supervision and control	Overall assessment
Spain (FEGA)	Food aid 2011	74 731	Effective	Partially effective 1	Effective	Effective	Effective
Italy (AGEA)	Food aid 2012	22 103	Effective	Partially effective 2	Effective	Effective	Effective

(\*) Does not include the value of the intervention stocks.

- 1 Spain has been allocated cereals and skimmed milk powder held in intervention storage in France and in Ireland respectively. For both products, the successful bidders received reimbursement of the transport costs to Spain. The EU-legislation provides that in such cases, transport to the country of destination should be verified by a specific procedure (T5 form) which the French and Irish authorities refused to open. Thus, the Spanish authorities used an alternative procedure which the Court considers to be less effective.
- 2 Italy organised a joint tendering procedure to deliver pasta in Italy and in Malta partly in exchange for cereals held in intervention storage. As a result of this procedure, Malta should have received 224 tonnes of pasta corresponding to its quantity of cereals. However, due to an administrative error Italy only delivered 180 tonnes of pasta to Malta.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR AGRICULTURE: MARKET AND DIRECT SUPPORT

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	3.58. Following this review as well as the findings and conclusions for 2010, the Court recommends that the Commission takes appropriate action to ensure that:  (a) the use of ortho-photos becomes mandatory and that the LPIS is regularly updated on the basis of new ortho-photos (see paragraph 3.31) <sup>(1)</sup> ;		X					
	(b) the paying agencies remedy the weaknesses identified where the control systems and IACS databases were found to be deficient (see paragraphs 3.23 to 3.25) <sup>(1)</sup> ;		X					
	(c) the on-the-spot inspections are of the quality necessary to identify the eligible area in a reliable manner (see paragraphs 3.38 and 3.39);			X				
	(d) the quality of inspections is adequately checked and reported by the certification bodies (see paragraphs 3.46 and 3.47).			X				
2009	3.73. The Court recommends that the systems weaknesses identified are resolved. In this regard, the most urgent deficiencies to be addressed for the SPS and SAPS are:  (c) to clarify and enforce further the rules so that EU direct aid is not paid to claimants who have neither used the land for farming nor maintained it in GAEC;			X				
	(d) to set at EU level minimum annual maintenance requirements for grassland to be eligible for EU direct aid.				X			

<sup>(1)</sup> Similar recommendations were made in paragraph 3.73(a) and (b) of the 2009 annual report.



Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2009	3.75. Furthermore, the Court considers that the Commission guidelines as regards the work to be performed by certification bodies must be reviewed concerning the nature, coverage and reporting obligations, especially as regards the work related to the validation of Member States' control and inspection statistics.			X				



## CHAPTER 4

**Rural development, environment, fisheries and health**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

4.1. This chapter presents the specific assessment of rural development, environment, fisheries and health, which comprises the rural development part of policy area 'Agriculture and rural development', together with policy areas 'Maritime affairs and fisheries', 'Health and consumer protection' and 'Environment and climate action'. Key information on the activities covered and the spending in 2012 is provided in **Table 4.1**.

Table 4.1 — Rural development, environment, fisheries and health — key information 2012

(million euro)

Policy area	Description	Payments	Management mode
Rural development	Rural development	13 258	Shared
	Pre-accession measures	7	Decentralised
	International aspects of 'Agriculture and rural development' policy area	4	Centralised direct
		<b>13 269</b>	
Maritime affairs and fisheries	Operational expenditure	705	Centralised / Shared
	Administrative expenditure	40	Centralised direct
		<b>745</b>	
Health and consumer protection	Operational expenditure	518	Centralised direct / Centralised indirect
	Administrative expenditure	117	Centralised direct
		<b>635</b>	
Environment and climate action	Operational expenditure	286	Centralised direct / Centralised indirect
	Administrative expenditure	96	Centralised direct
		<b>382</b>	
Total payments for the year		<b>15 031</b>	
– total administrative expenditure <sup>(1)</sup>		253	
Total operational expenditure		<b>14 778</b>	
– advances <sup>(2)</sup>		500	
+ clearings of advances <sup>(2)</sup>		716	
<b>Audited population, total</b>		<b>14 994</b>	
<b>Total commitments for the year</b>		<b>16 972</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 9.

<sup>(2)</sup> In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 6).

Source: 2012 consolidated accounts of the European Union.

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group**

4.2. Rural development is part of the common agricultural policy (CAP), for which the overall objectives and the sources of funding are presented in chapter 3 (paragraphs 3.2 and 3.3). Also the management and control of CAP expenditure is described in chapter 3 (paragraphs 3.6 and 3.7).

4.3. The European Agricultural Fund for Rural Development (EAFRD) co-finances at varying rates rural development expenditure through Member States' rural development programmes (13 269 million euro expenditure in 2012) <sup>(1)</sup>. The expenditure covers 45 measures which include both area-related measures (such as agri-environment payments and compensatory payments to farmers in areas with natural handicaps) and non-area-related measures (such as modernisation of agricultural holdings and the setting up of basic services for the economy and rural population).

4.4. The Union's policy on the environment is designed to contribute to protecting and improving environmental quality, the life of its citizens, and the rational utilisation of natural resources, including at international level. The financial instrument for the environment (LIFE) <sup>(2)</sup> is the most important programme in terms of funding (212 million euro expenditure in 2012) for co-financing projects in the Member States relating to nature and biodiversity; environment policy and governance; and information and communication.

4.5. The common fisheries policy of the policy area 'Maritime affairs and fisheries' pursues similar overall objectives as the common agricultural policy (see chapter 3, paragraph 3.2). The European Fisheries Fund <sup>(3)</sup> (EFF) is the main instrument (478 million euro expenditure in 2012).

<sup>(1)</sup> This amount includes payments for completion of earlier (2000-2006) programmes (135 million euro) and for other measures (genetic resources) (1,2 million euro).

<sup>(2)</sup> Regulation (EC) No 614/2007 of the European Parliament and of the Council (OJ L 149, 9.6.2007, p. 1).

<sup>(3)</sup> Council Regulation (EC) No 1198/2006 (OJ L 223, 15.8.2006, p. 1).

## THE COURT'S OBSERVATIONS

4.6. Concerning health and consumer protection, the EU contributes both to human, animal and plant health protection and to consumer welfare. The majority of payments are made for animal disease eradication programmes and EU agencies <sup>(4)</sup> (215 million euro and 167 million euro respectively in 2012).

4.7. The main risk to regularity for the policy group as a whole is that expenditure is ineligible, due to non-compliance with often complex rules and eligibility conditions. For rural development this risk is further increased for some programmes with low implementation rates, where ineligible expenditure may be declared to avoid Member States losing EU funding.

### Audit scope and approach

4.8. **Annex 1.1**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of rural development, environment, fisheries and health, the following specific points should be noted:

- the audit involved an examination of a sample of 177 transactions as defined in **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of transactions within the policy group. In 2012 the sample consisted of 160 transactions for rural development <sup>(5)</sup> and 17 concerning environment, fisheries and health <sup>(6)</sup>,

## THE COMMISSION'S REPLIES

4.7. As regards the complex rules and eligibility conditions referred to by the Court, the Commission points out that they are, to a certain extent, a consequence of the ambitious objectives of rural development policy.

Furthermore, the Commission would like to point out that in the framework of its audits upon which the Court's observations in this chapter are based, the Court found only a few cases to support its assertion of a further increase in the risk to regularity for rural development due to Member States' declaring ineligible expenditure in order to avoid losing EU funding.

The Commission itself has observed that some Member States make extensive use of advance payments and of financial engineering instruments which can have the effect of reducing or avoiding a loss of funds under the N+2 rules. In order to mitigate this risk, the Commission services have addressed these issues with Member States concerned.

4.8. See detailed comments in chapter 1.

- The Commission is closely following the developments of the Court's methodology, including two stage sampling, in view of any potential impact on the estimated error rate.

<sup>(4)</sup> European Centre for Disease Prevention and Control, European Food Safety Authority, European Medicines Agency.

<sup>(5)</sup> Czech Republic, Germany (Brandenburg and Berlin, Schleswig-Holstein), Greece, Spain (Andalucía), France, Italy (Basilicata, Bolzano, Sardegna), Lithuania, Austria, Poland, Portugal, Romania, Slovenia, Finland and the United Kingdom (England, Scotland).

<sup>(6)</sup> The sample consisted of 11 transactions under direct management; and 6 under shared management in the Czech Republic, Greece, Spain, Poland and the United Kingdom.

## THE COURT'S OBSERVATIONS

- the Court focused its testing of cross-compliance on GAEC (good agricultural and environmental condition) obligations and selected SMRs (statutory management requirements) <sup>(7)</sup> for which evidence could be obtained and a conclusion reached at the time of the audit visits,
- reductions and exclusions (to be applied by Member States in cases where beneficiaries of EU aid over-claim the actual area, number of animals or eligible expenditure <sup>(8)</sup>) are not included in the Court's error rate calculation <sup>(9)</sup>,
- the assessment of systems for rural development examined seven paying agencies <sup>(10)</sup> in six Member States: Bulgaria, Germany (Brandenburg and Berlin), France, Poland, Romania (both paying agencies) and Sweden. For health and consumer protection, the Court tested the internal control system of DG SANCO <sup>(11)</sup>,
- the Commission's annual activity reports of DG AGRI <sup>(12)</sup> (concerning rural development) and DG MARE <sup>(13)</sup> were reviewed,
- in addition, in order to assess the basis for the Commission's clearance decisions the Court reviewed DG AGRI's clearance of accounts audit work (for EAGF and for EAFRD) and visited the certification bodies of Bulgaria, Luxembourg, Romania and the United Kingdom (Northern Ireland).

## THE COMMISSION'S REPLIES

- *The respect of cross-compliance obligations does not constitute an eligibility criterion for CAP payments and, therefore, the controls of these requirements do not pertain to the legality and regularity of the underlying transactions. Cross-compliance is a mechanism by which farmers are penalised when they do not respect a series of rules which stem in general from other policies than the CAP and apply to EU citizens independently of the CAP. Thus the Commission considers that penalties imposed for violations of cross-compliance requirements should not be taken into account for the calculation of the error rates for the CAP.*

<sup>(7)</sup> All requirements for SMRs 6-8 (concerning the identification and registration of animals) and obvious non-compliance with SMRs 1 (Birds Directive), 2 (Groundwater Directive), 4 (Nitrates Directive), and 16 and 18 (animal welfare).

<sup>(8)</sup> Articles 16, 17 and 30 of Commission Regulation (EU) No 65/2011 of 27 January 2011 laying down detailed rules for the implementation of Council Regulation (EC) No 1698/2005, as regards the implementation of control procedures as well as cross-compliance in respect of rural development support measures (OJ L 25, 28.1.2011, p. 8).

<sup>(9)</sup> Except in cases where Member States had already found the irregularity without applying the due reductions/exclusions.

<sup>(10)</sup> The paying agencies and key controls were selected on the basis of a risk analysis.

<sup>(11)</sup> The Commission's Directorate General for Health and Consumers (DG SANCO).

<sup>(12)</sup> The Commission's Directorate General for Agriculture and Rural Development (DG AGRI).

<sup>(13)</sup> The Commission's Directorate General for Maritime Affairs and Fisheries (DG MARE).

## THE COURT'S OBSERVATIONS

**REGULARITY OF TRANSACTIONS**

4.9. *Annex 4.1* contains a summary of the results of transaction testing. Out of the 177 transactions audited by the Court 111 (63 %) were affected by error. On the basis of the errors which it had quantified, the Court estimates the most likely error to be 7,9 % <sup>(14)</sup>.

**Rural development**

4.10. With regard to rural development expenditure, of 160 transactions sampled, 101 (63 %) were affected by error, of which 59 (58 %) were quantifiable errors.

4.11. For the majority of transactions affected by error, the Court considers that the national authorities had enough information to detect and correct the errors concerned.

4.12. Transaction testing resulted in examining transactions for 27 different measures. Of the 160 transactions, 80 were area-related and 80 non-area-related. Errors were found in all Member States and in almost all measures included in the sample. As in 2011, the major component (65 %) of the most likely error reported in paragraph 4.9 concerned non-area-related measures.

## THE COMMISSION'S REPLIES

4.9. The Commission takes note of the most likely error rate estimated by the Court. It does not share the Court's assessment of the legality and regularity of one transaction. This leads to a lower estimate by the Commission of the level of undue payments.

While aware that the action plan developed in 2012 will not have an immediate impact, the Commission notes that the level of error estimated by the Court has remained stable. See also replies to 1.12 and 1.13 on the impact of recoveries and financial corrections on the protection of the financial interests of the EU.

4.10. The Director-General for DG AGRI has maintained a reservation concerning rural development expenditure in his declaration of assurance for 2012.

This reservation is accompanied by a number of corrective actions determined by the Commission together with the 27 Member States in order to address the situation.

The error rate for rural development must also be appreciated in light of the ambitious objectives of rural development policy.

4.11. The Commission shares the view that the national authorities could potentially have detected many of the errors found by the Court: the CAP rules provide the Member states with all necessary instruments to mitigate most of the risks of errors. Following the reservations in 2011 and 2012 by the Director-General for DG AGRI, extensive action plans have been implemented in collaboration with the Member States to identify the root causes of errors and appropriate remedial actions.

4.12. During their own audits in some Member States the Commission services found shortcomings similar to those detected by the Court of Auditors.

The discrepancy between the errors found by the Court and the errors found by Member States during their controls, as reported annually to the Commission, appears to be more noticeable for non-area related measures not governed by the Integrated Administrative and Control System (IACS). This confirms that when well implemented IACS is an effective system to mitigate appropriately the risk of errors.

<sup>(14)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 4,5 % and 11,3 % (the lower and upper error limits respectively).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.13. The reason for most quantifiable errors was that the beneficiaries did not respect the eligibility requirements, in particular those concerning:

- (a) agri-environment commitments;
- (b) specific requirements for investment projects;
- (c) procurement rules.

An analysis of each of these is set out in the following paragraphs.

4.14. The sample of 160 transactions included 43 for agri-environment. The Court found that in 11 cases (26 %), the farmers had not respected the agri-environmental commitments they had undertaken. An example of such an error found by the Court is provided in Box 4.1.

**Box 4.1 — Example of eligibility error: non-respect of agri-environment commitments**

A beneficiary in Poland committed to respect, on nine parcels (141,59 hectares), specific requirements related to the maintenance of extensive permanent grassland and the protection of endangered bird species and their habitats. The main commitment was to leave every year, on a different surface area, 5 to 10 % of the parcels uncut, for which the beneficiary would receive 270 euro per hectare. The Court found that on several parcels the requirements were not met: one parcel was completely cut, while on others either the uncut area was the same as in previous years or in a different location to that indicated by the ornithological expert. Only on two of the nine parcels declared (21,02 hectares) were all the requirements respected.

Similar cases of non compliance with agri-environment requirements were detected in the Czech Republic, Germany (Schleswig-Holstein), Greece, France and the United Kingdom (England).

*The action plans mentioned under point 4.11, in particular the ones following the AAR 2012, address specifically issues related to non-area related measures.*

*For some cases reported the error does not entail a financial impact of the same level as the error reported by the Court.*

*As regards the examples mentioned by the Court in Boxes 4.1-4.4 and 4.6, the Commission services will follow them up with the national authorities and, where appropriate, through the conformity clearance procedure.*

**4.14.** *The Commission has audited the implementation of agri-environmental measures in all Member States in the 2007-2013 programming period. Remaining weaknesses notwithstanding, the overall quality of the implementation has improved over the period.*

*The example in Box 4.1 will be followed-up by the Commission with the Polish authorities. Notwithstanding this error, the Commission's overall assessment of the system in Poland is that improvements have been made.*

**Box 4.1 — Example of eligibility error: non-respect of agri-environment commitments**

*The Commission has in its audits on implementation of agri-environmental measures detected scope for improvements in the control system to better assess the farmers' compliance with the commitments made.*

*Regarding the Member States mentioned by the Court, conformity clearance procedures are ongoing for Poland, Czech Republic, France and the United Kingdom (England), which will lead to financial corrections where appropriate.*

## THE COURT'S OBSERVATIONS

4.15. Eligibility criteria and selection procedures help target the aid to certain categories of beneficiaries, thus aiming to improve the effectiveness of rural development spending. However, of the 80 transactions related to investment projects included in the sample audited, 21 (26 %) did not respect the eligibility requirements. An example of this type of error is in Box 4.2.

**Box 4.2 — Example of eligibility error: non-respect of eligibility requirements for an investment project**

In Spain (Andalucía), a beneficiary received a 1,4 million euro grant to modernise the irrigation infrastructure, on two conditions: the project should be economically viable and water consumption should be maintained at or decreased from the 3 000 m<sup>3</sup> per hectare per year which the beneficiary had at the time of grant application. The Court found that neither condition was fulfilled. The project was not economically viable at the time of grant application and should have been rejected; water consumption in excess of 6 000 m<sup>3</sup> per hectare per year, double the beneficiary's water rights at that time, would have been required to meet this condition. Water consumption was not maintained or decreased as required, but instead increased upon project completion to 8 000 m<sup>3</sup> per hectare per year, meaning that the payment should not have been made. Failure to respect the two eligibility conditions renders the expenditure ineligible.

Non-respect of eligibility requirements for investment projects was also found in Germany (Schleswig-Holstein), Greece, France, Italy (Bolzano, Sardegna), Lithuania, Poland, Portugal, Romania and the United Kingdom (England).

4.16. In 26 of the 160 transactions audited, the beneficiary was required to respect public procurement rules. The Court found that in 17 cases (65 %), one or more of these rules were not respected, 5 of which were classified as serious infringements, an illustration of which is in Box 4.3.

## THE COMMISSION'S REPLIES

**4.15.** *The Commission has in its audits also identified in some Member States weaknesses in the implementation of selection criteria and has applied financial corrections in this respect. In the action plans for reducing the rural development error rate, selection criteria is one of the areas addressed.*

*The example in Box 4.2 is being followed-up by the Commission in the framework of the conformity clearance procedure.*

**4.16.** *Non-respect of procurement rules does not necessarily entail that 100 % of the expenditure concerned has been misused as the project as such may still meet its objective and provide added value. See also point 4.25.*

## THE COURT'S OBSERVATIONS

**Box 4.3 — Example of eligibility error: breach of public procurement rules**

In Romania, the beneficiary (a rural municipality) applied for support for an investment project which included a water supply network, a sewage system, improvement of local roads and a community building. Seven tenderers submitted offers, of which the beneficiary rejected five as not fulfilling the requirements. The Court found that the winning tenderer did not respect two tender requirements, and, moreover, that other bids had been excluded for not respecting precisely those requirements. Due to the non-compliance with the tender dossier and the non-respect of the principle of equal treatment, which influenced the outcome of the tender, the expenditure concerned is ineligible.

The Court found cases of a breach of public procurement rules also in Spain (Andalucía), France, Lithuania, Poland and Slovenia.

## THE COMMISSION'S REPLIES

**Box 4.3 — Example of eligibility error: breach of public procurement rules**

*Concerning Romania, the Commission has in its audits also found substantial weaknesses, and a clearance of account procedure is ongoing. The Commission services will follow the Court's findings up vis-à-vis the national authorities with a view to protecting the financial interest of the EU and recovering any undue payments.*

4.17. The Court found that 35 % of all errors affected more payments than the one examined, an example of which is in Box 4.4.

**Box 4.4 — Example of recurrent eligibility error: ineligible VAT included**

In France, the beneficiary for the measure Conservation and upgrading of the rural heritage was a public body. The latter declared expenditure including VAT, which was accepted by the paying agency and co-financed by the EU budget. However, the applicable legal basis stipulates that VAT is ineligible for bodies governed by public law in respect of the activities or transactions in which they engage as public authorities. The Court found that the paying agency had repeatedly accepted ineligible VAT also for other payments.

Recurrent errors with a financial impact were also found in Spain (Andalucía), Italy (Bolzano), Poland, Portugal and Romania.

**Box 4.4 — Example of recurrent eligibility error: ineligible VAT included**

*In the framework of the conformity clearance procedure, the Commission services will follow-up the Court's findings vis-à-vis the national authorities with a view to protecting the financial interest of the EU and recovering any undue payments.*

## THE COURT'S OBSERVATIONS

4.18. Under certain EAFRD aid schemes <sup>(15)</sup>, beneficiaries of EU aid have a legal obligation to fulfil 'cross-compliance' conditions, as described in chapter 3 (paragraph 3.5). The Court found one or more cross-compliance infringements in 25 (33 %) of the 75 payments subject to cross-compliance <sup>(16)</sup>. The Court noted significant problems in particular concerning the implementation of cross-compliance requirements for the identification and registration of animals.

**Environment, fisheries and health**

4.19. As regards environment, fisheries and health, of 17 transactions sampled, 10 (59 %) were affected by errors of which 4 (40 %) were quantifiable errors. The main reason for the quantifiable errors was that the beneficiaries did not respect the eligibility requirements. An example is outlined in Box 4.5.

**Box 4.5 — Example of eligibility error: non-respect of the principle of complementarity**

The LIFE programme does not finance measures covered by other EU financial instruments. This principle of 'complementarity' means that beneficiaries must ensure that no other direct or indirect EU funding is used to co-finance their LIFE project. A beneficiary of a LIFE project in Hungary to restore a marsh habitat also received other EU aid (including NATURA 2000 habitats and less-favoured areas) for the same land used for the LIFE project. This situation was accepted by the Commission which authorised payment of the aid. Due to the non-respect of the complementarity principle, the expenditure concerned is partly ineligible.

## THE COMMISSION'S REPLIES

**4.18.** The respect of cross-compliance obligations does not constitute an eligibility criterion for CAP payments and, therefore, the controls of these requirements do not pertain to the legality and regularity of the underlying transactions. Cross-compliance is a mechanism by which farmers are penalised when they do not respect a series of rules which stem in general from other policies than the CAP and apply to EU citizens independently of the CAP. Thus, the Commission considers that penalties imposed for violations of cross-compliance requirements should not be taken into account for the calculation of the error rates for the CAP.

Concerning the significant problems found for the identification and registration of animals, DG AGRI shares the Court's observation and pays particular attention to these requirements during its cross-compliance audits.

**Box 4.5 — Example of eligibility error: non-respect of the principle of complementarity**

The aids quoted by the Court do not concern directly or indirectly the LIFE project or specific action within it, but represent compensations to land owners deriving from specific provisions of the Rural Development scheme. These compensations do not refer to any specific actions included in the project. They are of different scope and different purpose of the LIFE project. The Commission considers that these amounts may not be treated as a direct or indirect financing to the project.

<sup>(15)</sup> As set out in Article 50a of Council Regulation (EC) No 1698/2005 (OJ L 277, 21.10.2005, p. 1).

<sup>(16)</sup> The infringements observed account for 0,4 percentage points of the error rate presented by the Court in paragraph 4.9.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## EFFECTIVENESS OF SYSTEMS

## Rural development

*Member States' systems related to the regularity of transactions*

4.20. **Annex 4.2** contains a summary of the results of the Court's examination of Member States' supervisory and control systems <sup>(17)</sup>.

4.21. In this regard, Member States' authorities are responsible for putting in place and operating in particular:

- (a) appropriate administrative and control procedures to ensure the accuracy of the declarations made by the claimant and the fulfilment of the eligibility requirements for the granting of the aid;
- (b) on-the-spot checks which, depending on the aid scheme, should cover at least 5 % of all beneficiaries or of the expenditure <sup>(18)</sup>. Appropriate procedures should be in place for selecting the beneficiaries, the quality and reporting of the checks and the adequacy of the corrections made;
- (c) a system guaranteeing an effective control of the respect of cross-compliance.

**4.20.** Common reply to paragraphs 4.20 and 4.21:

Indeed, it is the responsibility of the Member States' authorities to ensure that the administrative and control system in place meets the legal requirements and ensures that there is no financial risk to the EAGF and EAFRD funds.

The shared management system of the EAGF and EAFRD funds is such that if weaknesses are present which lead to financial risks to the funds the Commission shall impose net financial corrections on the Member States concerned.

The Commission is aware of weaknesses in the Member States' control system for EAFRD, especially for non-IACS measures. The certification bodies (CB) report on these weaknesses in their annual certification reports. The CBs make recommendations to improve the control systems and follow up their recommendations. The Commission takes the findings of the CBs into account, as well as other available information, when performing its risk analysis and establishing its own audit program in the framework of the conformity clearance procedure.

<sup>(17)</sup> For area-related rural development measures, such as agri-environment, verification of certain key elements such as eligible area is made through the Integrated Administration and Control System (IACS), described in chapter 3 (paragraph 3.18). Other eligibility requirements are governed by specifically designed controls. As described in chapter 3 (**Annex 3.2**) the Court found the IACS systems to be partially effective in one paying agency and not effective in two others.

<sup>(18)</sup> Articles 12 and 25 of Regulation (EU) No 65/2011.

## THE COURT'S OBSERVATIONS

4.22. For France, the Court reported in the 2010 annual report that the systems were not effective <sup>(19)</sup>. For DAS 2012 a follow-up mission was carried out to check if the weaknesses reported in 2010 were addressed. The Court found that four <sup>(20)</sup> out of the seven deficiencies reported were still not or not completely remedied in the region visited (Midi-Pyrénées). In addition, the results from the transaction testing in three other regions in France showed that in these regions a fifth weakness <sup>(21)</sup> still persisted.

4.23. For the other five Member States, the Court's audit covered compliance with the provisions of the relevant regulations and an assessment of the effectiveness of the systems in ensuring the regularity of transactions. In particular the three elements set out in paragraph 4.21 were examined.

4.24. For these five Member States, the Court identified the following main weaknesses:

- deficiencies in administrative checks related to eligibility conditions and commitments in all five Member States, such as non-detection of ineligible VAT or double financing,
- insufficient evaluation of the reasonableness of the costs (Germany (Brandenburg and Berlin), Poland, Romania and Sweden),
- weaknesses in the application of reductions or recoveries in all five Member States,

## THE COMMISSION'S REPLIES

**4.22.** For the two last consecutive years the Certification Body has reported significant problems in the control system of EAFRD in France, financial correction procedures were opened for both years concerned.

*The French authorities have been requested to address the weaknesses found and this will be followed up under the already open procedures.*

*The Commission services have also found during their own audits in France repeated shortcomings similar to those detected by the Court of Auditors. Furthermore, the Commission services have followed-up the Court's findings and found three of the weaknesses found by ECA (lack of review of work by a senior staff, risk analysis not effective, insufficient random sample). The clearance of accounts procedure is ongoing.*

**4.24.** Whenever in the framework of its audits the Commission identifies weaknesses in administrative checks, it pursues them through the conformity clearance procedure to protect the EU's financial interests.

- *The Commission shares the view that administrative checks of the reasonableness of costs are essential for ensuring the effectiveness of the control system. The Commission has during its conformity audits also found weaknesses in the assessment of reasonableness of cost and has imposed financial corrections in this respect to protect the EU's financial interest.*
- *The issues mentioned by the Court of Auditors are also systematically examined during the Commission audits missions. When weaknesses are found, they lead to financial corrections imposed on Member States through the conformity clearance of accounts procedure as well as recommendations for improving the control systems.*

<sup>(19)</sup> 2010 annual report, Annex 3.2.2.

<sup>(20)</sup> Lack of systematic review of administrative checks; weaknesses in the procedure for selecting beneficiaries subject to on-the-spot checks; no verification of the reasonableness of the costs; insufficient checks on declared expenditure.

<sup>(21)</sup> Lack of checks for an eligibility condition for the measure compensatory payments to farmers in areas with natural handicaps.

## THE COURT'S OBSERVATIONS

- insufficient quality of on-the-spot checks in all five Member States, for instance not all commitments and obligations covered by these checks, and/or not all non-compliances detected,
- deficiencies in the design and implementation of the control system for cross-compliance checks in all five Member States, such as insufficient national GAEC standards or incorrect national implementation of the Nitrates Directive.

These weaknesses were very similar to those found and reported concerning the six different Member States which were audited last year <sup>(22)</sup>.

4.25. The most important weakness detected by the Court concerned ineffective checks of procurement rules, which were apparent in all five Member States. As an illustration, the Court examined 40 public procurement procedures in these five Member States, which revealed that 16 (40 %) were affected by error. In 6 of the 40 cases, ineligible expenditure was found. Overall, the audit detected more than 9 million euro of ineligible expenditure resulting from the non-respect of procurement rules. A case involving ineligible expenditure is given in Box 4.6.

## THE COMMISSION'S REPLIES

- *The Commission has carried out cross-compliance audits in the five Member States audited by the Court (although not in the same regions in Germany) and has also observed weaknesses in the definition and control of the GAEC standards and SMRs. When a risk for the funds has been clearly established, the Commission has applied a financial correction in the framework of those enquiries or is still in the middle of the clearance of accounts procedure in enquiries concerning these five Member States (RO, BG, PL, SE and DE).*

*The weaknesses mentioned by the Court are addressed in the extensive action plans implemented in collaboration with the Member States in response to the reservations regarding rural development expenditure in 2011 and 2012 in DG AGRI's annual activity reports 2011 and 2012, and expected to bear fruit in the coming years.*

4.25. *The Commission has also found substantial weaknesses in the respect of procurement rules and financial corrections will be imposed to cover the financial risk to the EAFRD.*

*Public procurement is also one of the central elements in the action plans mentioned under point 4.11.*

*However, it should be noted that non-respect of procurement rules does not necessarily entail that 100 % of the expenditure concerned is ineligible as the project as such may still meet its objective and provide added value.*

*The Commission services are working on establishing common guidelines for all EU funds for determining the level of financial corrections in cases of non-respect of public procurement rules — see also point 4.16.*

*Concerning Romania, the Commission has in its audits also found substantial weaknesses and a clearance of account procedure is ongoing. The Commission services will follow the Court's findings up vis-à-vis the national authorities with a view to protecting the financial interest of the EU and recovering any undue payments.*

<sup>(22)</sup> 2011 annual report, chapter 4, paragraphs 4.24 to 4.32.



## THE COURT'S OBSERVATIONS

**Box 4.6 — Example of insufficient quality of a Member State's administrative checks**

For one public procurement case checked in Germany (Brandenburg and Berlin), the paying agency itself was the beneficiary of more than 2,2 million euro EAFRD aid under the measure 'technical assistance', concerning the paying agency's outsourced IT system between 2008 and 2012.

The Court found that the contract for the IT system and subsequent IT maintenance order was awarded to a company through negotiated procedure without notice rather than through the required open or restricted procedure. Failure to follow the required procedures renders the expenditure ineligible for EU financing. The same situation concerning the award of contracts for IT systems occurred in 11 other German regions.

*Commission's systems related to the regularity of transactions***The Commission's clearance of accounts procedures**

4.26. Management of most expenditure on agriculture is shared between Member States and the Commission. Aid is paid by the Member States, which is then reimbursed by the Commission (on a monthly basis for EAGF and on a quarterly basis for EAFRD). To enable it to assume final responsibility for implementation of the budget, the Commission applies two separate clearance of accounts procedures <sup>(23)</sup>:

- (a) an *annual financial clearance procedure* covering the annual accounts and internal control system of each accredited paying agency. The resulting decision is based on audits carried out by independent certification bodies in the Member States, which are submitted to the Commission;
- (b) a *multiannual conformity clearance procedure*, which may lead to financial corrections for the Member State concerned if expenditure has infringed EU rules in one or several financial years. The resulting decisions are based on audits performed by the Commission.

<sup>(23)</sup> In accordance with the Financial Regulation and implementing rules applicable to the general budget of the European Communities.



## THE COURT'S OBSERVATIONS

4.27. Concerning the set-up of the Commission's conformity audit work, the Court found that most key elements were in place and compliant with the main regulatory requirements. The amount of spending covered by conformity work expressed as a percentage of total expenditure was 47 % in 2008 and 42 % in 2012. In the annual audit programme for 2013, the planned coverage is only 19 %. Concerning the conformity audit work performed, the Court detected weaknesses in relation to quality control, audit documentation, the manner of evaluating evidence and forming conclusions <sup>(24)</sup>.

## THE COMMISSION'S REPLIES

**4.27** Paragraphs 4.27 to 4.33 analyse the implementation of the conformity clearance procedure. With regard to the year 2012:

- as rightly observed by the Court in paragraph 4.33, the amount of flat rate corrections, as part of the total amount of financial corrections, decreased from 68 % in 2011 to 12 % in 2012; consequently more and more financial corrections are based on a more precise estimate of financial risk for the EU,
- as also observed by the Court in paragraph 4.29, the total amount of financial corrections has increased in recent years.

The lower audit coverage for 2013 referred to by the Court reflects a management decision taken by DG AGRI due to the need to use its limited resources for the acceleration of the treatment of open cases — which the increased recourse to calculated financial corrections instead of flat rates has made more complicated and resource demanding, as well as for the follow-up of action plans in place in the Member States. It is however noted that the real coverage is much higher as the conformity audits cover at least expenditure effected in the last 24 months (24-month rule); the figure for 2013, which is not relevant in the context of this report, will not be known until Spring 2014 when the annual expenditure declarations are received. It is emphasised that the audit coverage in the 2013 audit planning is indicative and it cannot be compared to the actual coverage in the previous years. In addition, the expenditure covered is that for which there is the highest risk.

It is noted that for the EAFRD, the number of audit missions increased from 23 in 2012 to 35 in 2013.

These three essential criteria indicate the effectiveness of the implementation of the conformity clearance procedure in mitigating the risk of errors. Nevertheless, and notably in the framework of the CAP reform, the Commission is considering further improvements.

The quality of the Commission's audit work is ensured through the '4 eyes' principle and all audit plans and reports are reviewed by and discussed with the hierarchy of the auditors. The audit work is documented through checklists and reports and, following the Court of Auditors' remarks in its annual report 2011, the audit documentation is being improved and harmonised.

<sup>(24)</sup> The lack of quality control and audit documentation was already pointed out in the 2011 annual report (chapter 4, paragraph 4.41).

## THE COURT'S OBSERVATIONS

4.28. The Commission's audits are systems based, and not aimed at checking the regularity of underlying transactions. Samples are selected on a judgemental or random basis, and cover expenditure relating to several budgetary years. The Commission's audit work is thus not intended to calculate an annual error rate.

4.29. In 2012, the Commission took three conformity decisions, leading to financial corrections of 651 million euro (503 million euro relating to EAGF and 148 million euro to EAFRD). The average amount of financial corrections in the last five-year period (2008 - 2012) was 30 % higher than in the preceding period (2003 - 2007), taking into account the budget increase between those two periods.

4.30. The use of flat rate corrections does not sufficiently take into account the nature and gravity of the infringement <sup>(25)</sup>, as the same flat rate correction of 5 % is applied, regardless of whether weaknesses were found for a single key control or for many such controls. However, while flat rate corrections have been much used in the past, there has been a notable reduction in 2012. Nevertheless, in 6 out of the 54 cases in 2012, the Commission reduced the initially proposed 5 % flat rate reduction to 2 % after the conciliation procedure.

4.31. A persistent problem with the conformity decisions is the length of the procedure. The Court already reported on this issue in its special report of 2010 <sup>(26)</sup>, but found that the situation has not improved. A sample of conformity procedures showed that in 2012 the actual time taken (more than four years) was twice that set down in the Commission's internal deadlines, resulting in a considerable backlog.

## THE COMMISSION'S REPLIES

4.28. The Commission's audits are based on a central risk analysis which determines the risky areas where audit activities and resources shall be concentrated in order to better protect the EU financial interests.

4.29. The Commission considers that this 30 % increase in financial corrections indicates that the effectiveness of the conformity procedure is not decreasing.

4.30. The Commission wishes to highlight the following elements with regard to this point. Only 12 % of the financial corrections in 2012 were flat rate corrections. The methodology for calculating financial corrections, which has been in force since 1997, is fully compatible and complies fully with Article 31(2) of Council Regulation (EC) No 1290/2005. It has been upheld by the Court of Justice, including for cases after the entry into force of R. 1290/2005. The Commission notes that the Court criticises the non-accumulation of flat-rate corrections.

The Court correctly points out that the Commission has reduced corrections following the conciliation procedure. In the six cases in question, as is the situation in all such cases, the Commission carefully examined the explanations and any new information provided by the Member States during this procedure before taking its well considered decision to reduce the initially proposed flat rate correction in order to best reflect the real risk to the EU budget. It is noted that it is in the very nature of the contradictory procedure to enable the Commission to move to a more fine-tuned calculation of the risk to the budget.

4.31. Notably in the framework of the preparation for the implementation of the CAP reform, the Commission will continue in its efforts to improve and speed up the process, bearing in mind the need to maintain quality standards and the Member State's right of reply.

<sup>(25)</sup> Article 31(2) of Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agriculture policy (OJ L 209, 11.8.2005, p. 1) specifies that 'The Commission shall assess the amounts to be excluded on the basis of the gravity of the non-conformity recorded. It shall take due account of the nature and gravity of the infringement and of the financial damage caused to the Community'.

<sup>(26)</sup> Special report No 7/2010, 'Audit of the clearance of accounts procedure', paragraphs 68 to 73 and 98.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.32. The Court found that the results of the conformity audits were not sufficiently taken into account for the financial clearance decision. This means that the reliance which can be placed on the financial clearance is reduced.

4.33. Although the Commission has increased the total amount of financial corrections in recent years, and has reduced the proportion of flat-rate corrections significantly in 2012 <sup>(27)</sup>, conformity clearance decisions are not yet taken in an appropriate and timely manner.

**The reinforcement of assurance procedure**

4.34. In 2010 the Commission introduced on a voluntary basis a new control framework called 'reinforcement of assurance on the legality and regularity of the transactions at the level of the final beneficiaries through the work of the certification bodies'. The proposed legal framework for the CAP after 2013 includes provisions to make this procedure compulsory for all Member States.

4.35. The reinforcement of assurance procedure means that certification bodies re-perform a representative sample of transactions which the paying agency has checked on the spot. If the Commission considers that Member States apply this procedure correctly, financial corrections in the context of the clearance of accounts may be limited to the error rate derived from the inspection statistics certified. So far, the Commission did not use this possibility as the conditions for such a capping have not been met.

4.32. Article 30 of Regulation (EC) No 1290/2005 clearly states that the financial clearance decision shall cover the completeness, accuracy and veracity of the annual accounts submitted by the paying agency. The decision shall be without prejudice to decisions taken subsequently under conformity clearance procedures. Therefore, the two procedures are distinct and autonomous, though obviously complementary. If the latter (conformity procedure) may be opened subsequently to the former, the financial clearance decision should not be based either on conformity audits findings or on the Court's findings pertaining to the regularity of expenditure, for obvious reasons of differences in terms of timing, nature and scope of the various exercises.

4.33. The increase in the total amount of financial corrections in recent years and the significant reduction of the proportion of flat-rate corrections in 2012 observed by the Court are strong indications that the system is effective. Nevertheless the Commission is considering improvements, notably as part of the implementation of the CAP reform and in view of better managing the procedure in terms of precision of the estimation of the EU financial risk and timing.

4.34. The reinforcement of assurance exercise was conceived as a first step in a development process towards greater assurance with regard to the control work carried out by the Member States. It has proven, in this preparatory phase, to be a useful joint learning exercise with its voluntary participants with a view to developing and fine-tuning the procedures and guidelines for the legality and regularity work required in the new CAP reform legislation.

4.35. Such a possible capping, under certain conditions, of the level of financial corrections to the said error rate relates to conformity clearance of accounts procedures. Indeed, if a Member State implements the proposal set out above and if the certification body confirms the reliability of the control statistics for a given population, any financial corrections for deficiencies in the Member State's management and control of an aid scheme within that population would be limited to the error rate derived from the control statistic concerned.

Where the certification body does not confirm the error rate derived from the control statistics of the paying agency, the conditions for capping financial corrections at the level of the error rate are not fulfilled.

<sup>(27)</sup> The amount of flat rate corrections as part of the total amount of financial corrections decreased from 68 % in 2011 to 12 % in 2012.

## THE COURT'S OBSERVATIONS

4.36. In 2012, the Court's audit included four of the five Member States which applied this procedure: two for EAFRD (Bulgaria and Romania) and two for EAGF (Luxembourg and the United Kingdom (Northern Ireland)). The Court noted serious deficiencies in the implementation of the procedure.

- Concerning EAFRD, the Court found that the data reported by the two certification bodies was not reliable. For instance, in Romania the Court re-performed the certification body's inspections and found ineligible features in 5 of the 10 cases tested.
- As regards EAGF, the Court's review of a sample of the payments audited by the respective certification bodies and the re-performance of a number of measurements carried out by those bodies showed significant differences. For example, for 12 out of 47 measurements re-performed by the Court in the United Kingdom (Northern Ireland), the measurement results differed by more than the applicable tolerance margin <sup>(28)</sup> from the results reported by the certification body.

**DG AGRI's annual activity report (AAR)**

4.37. DG AGRI's AAR contains a reservation for the total EAFRD expenditure for 2012 (13,3 billion euro). This reservation was issued due to DG AGRI's concerns about the quality of controls in some Member States as well as the error rate reported by the Court.

4.38. However, DG AGRI's reservation for EAFRD suffers from the following deficiencies:

## THE COMMISSION'S REPLIES

**4.36.** For Northern Ireland a verification mission on the quality of CB's work is planned once the country's reply to the ECA's report is received.

For Romania and Bulgaria, no verification missions are scheduled as the CB could not confirm the expenditure embedded in the control statistics. Nevertheless, a follow-up with those countries of the ECA's findings is ongoing in view of improving the quality of the CB's work for next years.

- Conformity clearance procedures related to EAFRD are ongoing for the two Member States concerned, the risk resulted from the identified weaknesses will be covered by financial corrections.
- See above.

**4.37.** The reservation was carried-over from 2011. But as indicated in the text of the reservation, the basis for the reservation has been broadened. The Court of Auditors' and DG AGRI own audits raise concerns about the quality of the controls performed by the Member States. The reservation was therefore carried-over to 2012 although the calculated residual error rate was below 2 %.

**4.38.** The reasons for the reservation on EAFRD are clearly explained in DG AGRI's AAR 2012. Given concerns regarding the quality of the controls in some Member States, and because it was not possible to use the new integrated approach adopted for decoupled direct aid, DG AGRI could not exclude that the true residual error rate was above materiality. However, given also that most of the actions carried out in 2012 in the framework of the comprehensive action plan set up to follow up the 2011 reservation could not produce a significant impact on the residual error rate before 2014 at the earliest, it was decided to maintain the 2011 reservation.

<sup>(28)</sup> Article 34(1) of Regulation (EC) No 1122/2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- on the basis of control statistics reported by the Member States to the Commission, the residual error rate (RER) <sup>(29)</sup> was 1,62 % (quantified by the Commission at 202,7 million euro). DG AGRI judged that the RER was likely to be higher than this and might exceed 2 %; it did not however provide its own quantified estimate of the RER,
- for the new approach followed for decoupled area aid, DG AGRI makes an assessment for each paying agency on whether or not to apply a higher error rate on the basis of information from its own audits (see chapter 3, paragraph 3.31). For rural development, this approach was not followed for 2012.

4.39. DG AGRI indicates in its reservation that, while a significant number of actions to address the increased level of error was taken, it will not be feasible to produce a significant impact on the error rate before 2014 at the earliest. The Court agrees with this latter assessment.

### Environment, fisheries and health

4.40. Environment, fisheries and health are managed by the Commission under specific control systems. The Court audited DG SANCO's internal control systems for procurement, timeliness of payments, and grant agreements. The audit found that these systems were partially effective. With regard to small contracts, there was an absence of clear criteria for assessing the financial and economic capacity of candidates, and insufficient documentation for the selection of candidates for negotiated or restricted tender procedures. On the spot ex ante verifications took a long time to be finalised which caused excessive payment delays and some payment delays were not correctly calculated. Regarding grant agreements managed by the Executive Agency for Health and Consumers, there was an absence of evidence of checks on potential conflicts of interest affecting external experts.

DG AGRI clearly discloses in its 2012 AAR (Section 3.1.1.1.7) that the new approach adopted for decoupled direct aids would not, mainly due to timing reasons, be applied for rural development in that report. As indicated in the Commission Synthesis Report for 2012, the new integrated approach will be further developed and will also be used for rural development expenditure in the DG AGRI 2013 AAR. This will enable a more accurate quantification of the amounts at risk.

**4.40.** For small contracts, the Commission uses general rather than specific financial viability criteria given the low financial risk involved in small contracts of a short duration that do not foresee pre-financing payments.

As for the selection of candidates for negotiated and restricted tendering, the procedure is currently being updated in view of the entry into force of the new Financial Regulation.

The finalisation of on-site audits conducted by the Commission in Member States, prior to launching the final payment, took a relatively long time as many outstanding issues had to be clarified with the auditee. During this period, the Member States received meanwhile first and second tranches of the estimated due payment.

<sup>(29)</sup> The residual error rate is an estimate of the error which remains after correction of the errors detected by the Member States' supervisory and control systems.

## THE COURT'S OBSERVATIONS

4.41. The Court has no specific observations to make on the annual activity report of DG MARE as regards the regularity of the underlying transactions.

## CONCLUSIONS AND RECOMMENDATIONS

### The conclusion for 2012

4.42. For this policy group,

- testing of transactions indicates that the most likely error present in the population is 7,9 %, and
- the examined supervisory and control systems<sup>(30)</sup> are assessed as partially effective. Of the six Member States' rural development systems audited, one was not effective (Romania) and the other five were partially effective (Bulgaria, Germany (Brandenburg and Berlin), France, Poland and Sweden).

Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

### Recommendations

4.43. **Annex 4.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented seven recommendations. Out of these recommendations, one was implemented in most respects and six in some respects.

## THE COMMISSION'S REPLIES

*The checks of external experts form part of the standard written guidelines on the Agency's working procedures. Moreover, conflict of interest aspects are managed through declarations by the experts and the composition of evaluation panels putting individual experts in a minority position. The Agency will update its evidence of checks in line with the auditor's conclusions.*

4.42.

- *The Commission takes note of the most likely error rate estimated by the Court. It does not share the Court's assessment of the legality and regularity of one transaction. This leads to a lower estimate by the Commission of the level of undue payments.*

*The testing of transactions as established by the Court indicates that the estimated level of error has remained stable compared to last year.*

- *The Commission notes that the results presented are similar to the results of last year.*

*Notably concerning Romania, the Commission has in its audits also found substantial weaknesses and clearance of accounts procedures are ongoing. Also for Bulgaria the Commission in its audits has found weaknesses which are being followed up in the clearance of accounts.*

4.43. *The Commission considers as implemented the four recommendations pertaining to agriculture referred to by the Court.*

<sup>(30)</sup> All examined systems were selected on the basis of a risk analysis.



## THE COURT'S OBSERVATIONS

4.44. Following this review and the findings and conclusions for 2012, the Court recommends in the area of rural development that:

— **Recommendation 1:** the Member States carry out their existing administrative checks better, by using all relevant information available to the paying agencies, as this has the potential to detect and correct the majority of errors (see paragraphs 4.11 and 4.24);

— **Recommendation 2:** the Commission ensures that all cases where the Court detected errors are followed up appropriately (as identified in paragraphs 4.17, 4.24 and 4.25);

— **Recommendation 3:** the Commission, in DG AGRI's annual activity report, applies a similar approach for EAFRD as for decoupled area aid, where the Commission takes account of the results of its own conformity audits in assessing the error rate for each paying agency (see paragraph 4.38);

and for the CAP as a whole that:

— **Recommendation 4:** the Commission ensures adequate coverage in its conformity audits (see paragraph 4.27);

— **Recommendation 5:** the Commission addresses the weaknesses identified in its conformity audits and the persistent problem of long delays in the conformity procedure as a whole (see paragraphs 4.27, 4.31 and 4.33);

## THE COMMISSION'S REPLIES

**4.44.**

*The Commission shares the view that the Member States should carry out their administrative checks better.*

*In the context of the drafting of its implementing rules for the CAP reform, the Commission is considering how to strengthen the administrative and control systems to be used by the Member States and how to reinforce the various instruments (including suspension of payments) to be used by the Commission for better protecting the EU financial interest in cases where Member States do not play correctly their role under the shared management rules.*

*The Commission will ensure that all the systemic errors detected by the Court are followed up appropriately, including through its conformity procedure where appropriate.*

*The Commission has already clearly indicated in its synthesis report for 2012 that the new integrated approach will be further developed and will also be used for the EAFRD from the year 2013 reports. Furthermore it recalls that the integrated approach also takes into account the findings of the Court's systems audits and the findings of the certification bodies.*

*The Commission will take appropriate measures within the limits of the resources available.*

*The Commission will continue to improve its audit methodology and procedures. Moreover, it will continue to make efforts, notably in the framework of the preparation for the implementation of the CAP reform, to improve and speed up the process bearing in mind the need to maintain quality standards and the Member State's right of reply.*

## THE COURT'S OBSERVATIONS

- **Recommendation 6:** the Commission further improves its method of determining financial corrections so as to take better account of the nature and gravity of the infringements detected (see paragraph 4.30).

4.45. In the policy area of health and consumer protection that:

- **Recommendation 7:** the Commission addresses the weaknesses identified in systems for procurement and grant agreements (see paragraph 4.40).

## THE COMMISSION'S REPLIES

*As evidenced by the increase in the total amount of financial corrections in recent years and the significant reduction of the proportion of flat-rate corrections in 2012, recognised by the Court itself, the Commission has already improved its method of determining financial corrections.*

*That being said, the Commission always and as a matter of course strives to further improve its method of determining financial corrections, notably in the framework of the implementation of the CAP reform.*

**4.45.**

*The weaknesses will be addressed by better evidenced checks and updates to the procedures in view of the entry into force of the new Financial Regulation.*



## ANNEX 4.1

## RESULTS OF TRANSACTION TESTING FOR RURAL DEVELOPMENT, ENVIRONMENT, FISHERIES AND HEALTH

	2012			2011	2010	2009
	Rural development	Env., fish. and health	Total			
SIZE AND STRUCTURE OF THE SAMPLE						
Total transactions:	160	17	177	178	92	93
RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>						
Proportion (number) of transactions tested found to be:						
Free of error	37 % (59)	41 % (7)	37 % (66)	43 %	48 %	67 %
Affected by one or more errors	63 % (101)	59 % (10)	63 % (111)	57 %	52 %	33 %
Analysis of transactions affected by error						
Analysis by type of error						
Non-quantifiable errors:	42 % (42)	60 % (6)	43 % (48)	38 %	48 %	42 %
Quantifiable errors:	58 % (59)	40 % (4)	57 % (63)	62 %	52 %	58 %
Eligibility	71 % (42)	100 % (4)	73 % (46)	68 %	56 %	22 %
Occurrence	0 % (0)	0 % (0)	0 % (0)	2 %	0 %	6 %
Accuracy	29 % (17)	0 % (0)	27 % (17)	30 %	44 %	72 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate	7,9 %					
Upper error limit (UEL)	11,3 %					
Lower error limit (LEL)	4,5 %					

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 4.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR RURAL DEVELOPMENT

## Assessment of selected supervisory and control systems

Member State (Paying agency)	Administrative and control procedures	On-the-spot inspection methodology, selection, execution, quality control and reporting of results	Implementation and control of cross- compliance	Overall assessment
<b>France</b> (only follow-up of previous observations)	Partially effective	Partially effective	N/A	<b>Partially effective</b>
<b>Sweden</b>	Partially effective	Effective	Partially effective	<b>Partially effective</b>
<b>Germany</b> (Brandenburg and Berlin)	Partially effective	Partially effective	Partially effective	<b>Partially effective</b>
<b>Poland</b>	Partially effective	Effective	Effective	<b>Partially effective</b>
<b>Bulgaria</b>	Partially effective	Partially effective	Partially effective	<b>Partially effective</b>
<b>Romania</b> (Agency for Payments and Intervention in Agriculture (APIA) and Paying Agency for Rural Development and Fisheries (PARDF))	Not effective	Not effective	Not effective	<b>Not effective</b>

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR RURAL DEVELOPMENT, ENVIRONMENT, FISHERIES AND HEALTH

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	3.58(d) the quality of inspections is adequately checked and reported by the certification bodies.			X				
	3.59. In the area of rural development, the Court recommends that the Commission and the Member States remedy the weaknesses identified, notably by improving the effectiveness of the checks carried out for non-IACS measures.			X				
	3.60. Finally, effective measures need to be taken by the Commission and the Member States so that the issues identified in the policy areas of environment, fisheries, health and consumer protection are resolved.			X				
2009	3.74. The Court also reiterates that further efforts are required in the area of rural development to further simplify the rules and conditions.			X				
	3.75. Furthermore, the Court considers that the Commission guidelines as regards the work to be performed by certification bodies must be reviewed concerning the nature, coverage and reporting obligations, especially as regards the work related to the validation of Member States' control and inspection statistics.			X				
	3.76. Finally, effective measures need to be taken, together with the concerned national authorities, to avoid the payment of ineligible expenditure for fisheries projects.			X				
	3.76. Internal controls on payments for animal disease eradication and monitoring programmes to the Member States require a clear segregation of functions between the Commission services and the development of appropriate formal control procedures.		X					



## CHAPTER 5

**Regional policy, energy and transport**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

5.1. This chapter presents the specific assessment of regional policy, energy and transport, which comprises policy areas 'Regional policy' 'Mobility and transport', and 'Energy'. Key information on the activities covered and spending in 2012 is provided in **Table 5.1**.

**Table 5.1 — Regional policy; transport and energy — Key information 2012**

(million euro)

Policy area	Description	Payments	Management mode
Regional policy	European Regional Development Fund and other regional operations	27 466	Shared
	Cohesion Fund	9 622	Shared
	Solidarity Fund	726	Shared
	Pre-accession operations related to structural policies	354	Decentralised
	Administrative expenditure	86	Centralised direct
		<b>38 254</b>	
Mobility and transport	Trans-European Networks (TENs)	819	Centralised direct/Centralised indirect
	Inland, air and maritime transport	158	Centralised direct/Centralised indirect
	Administrative expenditure	65	Centralised direct
	Research related to transport	63	Centralised direct
		<b>1 105</b>	
Energy	Conventional and renewable energies	285	Centralised direct Centralised indirect/Joint management
	Nuclear energy	197	Centralised direct/ Centralised indirect/Joint management
	Research related to energy	152	Centralised direct
	Administrative expenditure	78	Centralised direct
	Trans-European Networks (TENs)	11	Centralised direct
		<b>723</b>	
Total payments for the year		<b>40 082</b>	
– total administrative expenditure <sup>(1)</sup>		229	
Total operational expenditure		<b>39 853</b>	
– advances <sup>(2)</sup>		1 871	
+ clearings of advances <sup>(2)</sup>		2 753	
<b>Audited population, total</b>		<b>40 735</b>	
<b>Total commitments for the year</b>		<b>45 091</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 9.

<sup>(2)</sup> In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 6).

Source: 2012 consolidated accounts of the European Union.

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THE COURT'S OBSERVATIONS

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5.2. Regional policy, mostly implemented through the European Regional Development Fund (ERDF) and the Cohesion Fund (CF), accounts for 96 % of spending of the policy areas covered by this chapter while the remaining 4 % concerns the transport and energy areas.

5.3. The ERDF (with payments of 27,5 billion euro) and the CF (with payments of 9,6 billion euro) accounted for 97 % of the expenditure under regional policy in 2012 <sup>(1)</sup>. Payments in the fields of transport and energy reached 1,8 billion euro in 2012. Around 45 % of transport and energy expenditure was for the trans-European Networks (TEN) programmes, and 16 % was for conventional and renewable energy projects <sup>(2)</sup>.

## Specific characteristics of the policy areas

### *Policy objectives*

#### **Regional policy**

5.4. Regional policy aims to strengthen economic, social and territorial cohesion within the European Union by reducing development disparities between different regions.

#### **Transport and energy**

5.5. Transport and energy policies aim to provide European citizens and businesses with secure, sustainable and competitive transport and energy systems and services and to develop innovative solutions that contribute to the formulation and implementation of these policies.

### *Policy instruments*

#### **Regional policy**

5.6. The ERDF finances infrastructure works, the creation or preservation of jobs, regional economic development initiatives and activities supporting small and medium-sized enterprises.

5.7. The CF finances investments in infrastructure in the fields of environment and transport in Member States whose gross national income per capita is below 90 % of the EU average.

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<sup>(1)</sup> The other two main categories of expenditure for regional policy were for projects under the EU Solidarity Fund (2 %) and projects under the Instrument for Pre-Accession Assistance (1 %).

<sup>(2)</sup> The other three main categories of expenditure were for research projects mainly funded by the research framework programmes (12 %), for nuclear energy projects (11 %), and inland, air and maritime transport projects (9 %).

## THE COURT'S OBSERVATIONS

5.8. Other regional policy instruments include the EU Solidarity Fund, which provides support in the event of natural disasters in the Member States, and the Instrument for Pre-Accession Assistance, which helps candidate countries to prepare for the use of EU regional spending.

**Management and control of spending in cohesion policy funds under shared management**

5.9. The ERDF and CF, together with the European Social Fund (ESF), are part of the cohesion policy funds. These funds are governed by common rules, subject to exceptions in the specific regulations of each fund. The eligibility rules are laid down at national or sometimes regional level. Cohesion policy funds are implemented through multiannual programmes, in shared management arrangements between the Commission and the Member States. The same national authorities are often responsible for the management of all cohesion policy funds. The ESF, which is the subject of chapter 6, is referred to in this chapter where issues common to all the funds are discussed.

5.10. For each programming period, on the basis of Member States' proposals, the Commission approves operational programmes (OPs) and indicative financial plans which include the EU and national contributions <sup>(3)</sup>. Projects financed through the OPs are carried out by private individuals, associations, private or public undertakings or local, regional and national public bodies.

5.11. Authorities in the Member States select projects to achieve the objectives of the OP. The beneficiaries declare the costs incurred for these projects to their national authorities. These individual declarations are aggregated into periodic expenditure declarations per OP certified by the Member State authorities and submitted to the Commission. The share co-financed by the EU is then reimbursed from the EU budget.

## THE COMMISSION'S REPLIES

5.9. *The establishment of eligibility rules at national level (Article 56 of Council Regulation (EC) No 1083/2006) was one of the main elements of simplification introduced in the 2007-2013 programme period. It aimed at providing Member States with more flexibility in adapting eligibility rules to the specific needs of regions or programmes and to harmonise them with rules in force for other, national public schemes.*

<sup>(3)</sup> In total, 434 OPs have been approved by the Commission for the 2007-2013 programming period: 317 for ERDF/CF (out of which 24 OPs contain CF projects) and 117 for ESF.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Member States and regional level*

5.12. Member States bear primary responsibility for preventing or detecting and correcting irregular expenditure, and report on this subject to the Commission. Responsibility for day-to-day administration lies with designated managing authorities and intermediate bodies <sup>(4)</sup>. This includes selecting individual projects, implementing procedures and checks to prevent, detect and correct irregularities and verifying that projects are actually implemented ('first level checks'). Certifying authorities verify that 'first level checks' are effectively carried out and, where appropriate, undertake additional checks prior to declaring expenditure for reimbursement to the Commission. Managing and certifying authorities therefore play a key role in ensuring that the expenditure reimbursed by the Commission is regular.

5.13. Audit authorities (AAs) in the Member States are responsible for carrying out system audits and audits of operations in order to provide reasonable assurance on the effective functioning of the management and control systems of the programmes and on the regularity of the expenditure certified for each OP. They report on these audits to the Commission through annual control reports (ACRs) and annual opinions.

*Commission level*

5.14. The Commission has to obtain assurance that the Member States have set up management and control systems which meet the requirements of the regulations, and that the systems function effectively <sup>(5)</sup>. If the Commission finds that a Member State has failed to correct irregular expenditure, which had been certified and declared, or that there are serious failings in the management and control systems, the Commission may interrupt or suspend payments <sup>(6)</sup>. If the Member State does not withdraw the irregular expenditure (which may be substituted by eligible expenditure for other projects of the same OP) and/or does not remedy any detected system failures, the Commission may apply financial corrections, leading to a net reduction in EU funding <sup>(7)</sup>.

**5.14.** The Commission provided a detailed assessment of its assurance on the set up and subsequent functioning of management and control systems for each co-financed programme, as well as an overall assessment of national control systems in its 2012 AARs of the Structural Funds Directorates-General.

*In case of systems deficiency, the Commission in its supervisory role does interrupt and/or suspend payments. It reports on the exercise of this responsibility in the AAR (see page 45). For 2012, DG Regional and Urban Policy reports two suspensions of payments to ERDF programmes, the initiation of 66 pre-suspension procedures, 69 interruptions of payment deadlines and 119 preventive early warnings to Member States.*

<sup>(4)</sup> Intermediate bodies are public or private bodies acting under the responsibility of a managing authority and carrying out duties on their behalf.

<sup>(5)</sup> Article 72 of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25).

<sup>(6)</sup> Article 39(2) of Council Regulation (EC) No 1260/1999 (OJ L 161, 26.6.1999, p. 1); Articles 91 and 92 of Regulation (EC) No 1083/2006.

<sup>(7)</sup> Article 99 of Regulation (EC) No 1083/2006.

THE COURT'S OBSERVATIONS

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**Transport and energy**

5.15. The European Union's transport policies aim to develop the internal market, increase competition and innovation, and integrate transport networks. In this area, EU policies promote mobility, sustainable development and transport security. The TEN-T programme is the main financial instrument which provides funding for large infrastructure projects.

5.16. Energy policies aim to help provide citizens and business with affordable energy, competitive prices and technologically advanced energy services. It promotes sustainable energy production, transport and consumption, and a secure energy supply within the EU. The main financial instrument is the European Energy Programme for Recovery (EEPR) which provides financing for projects, largely in the form of grants and subsidies.

**Management and control of transport and energy spending under direct, indirect centralised and joint management**

5.17. The Commission (Directorate-General for Mobility and Transport and Directorate-General for Energy) implements transport and energy expenditure under direct and indirect centralised management (through two executive agencies and a joint undertaking<sup>(8)</sup>), and also through joint management arrangements (such as nuclear decommissioning funds or the European energy efficiency finance facility).

5.18. The Commission generally finances projects following formal calls for project proposals. Payments for approved projects are made directly by the Commission to beneficiaries, based on grant agreements or Commission decisions. The beneficiaries are usually Member State authorities but may also be public or private companies. Nearly all payments are made in instalments: an advance or pre-financing payment upon signature of the grant agreement or financing decision, followed by interim and final payments to reimburse eligible expenditure reported by beneficiaries.

5.19. The Commission evaluates proposals against specified selection and award criteria, provides information and guidance to beneficiaries, and monitors and verifies the implementation of projects based on financial and technical progress reports submitted by beneficiaries. Where required by grant agreements or Commission decisions, expenditure claims have to be certified by an independent auditor or a relevant national body.

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<sup>(8)</sup> Trans-European Transport Network Executive Agency, Executive Agency for Competitiveness and Innovation and SESAR (Single European Sky Air Traffic Management Research) Joint Undertaking.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.20. In addition, the Commission carries out *ex post* audits in order to detect and correct errors which may not have been prevented by earlier checks.

*Risks to regularity***Regional policy**

5.21. For ERDF and CF expenditure the main risks relate to the funding of projects which do not comply with EU and/or national public procurement rules or which do not fulfil the eligibility conditions. The risk also exists that beneficiaries may declare specific costs that are ineligible.

5.22. In implementing the OPs, Member State authorities face competing priorities. Spending has to be subject to appropriate checks intended to ensure regularity and value for money. At the same time, there is an interest in absorbing the funds allocated by the EU. This may in practice militate against the consistent application of effective controls.

5.23. There is also the risk that cases of non-compliance with the EU and/or national rules are not detected and/or corrected by the different layers of control in a Member State or by the Commission resulting in ineligible expenditure being ultimately reimbursed from the EU budget.

**Transport and energy**

5.24. For transport and energy expenditure the main risk is that ineligible costs declared by beneficiaries are not detected by the Commission before reimbursement. As under ERDF and CF, there are also risks related to non-compliance with public procurement rules.

5.21. The Commission shares this assessment, as detailed in its Staff Working Document 'Analysis of errors in the Cohesion Policy for the years 2006-2009' (SEC(2011) 1179 of 5 October 2011). In this document, the Commission indicates the specific actions in its undertaking to mitigate these risks (in particular additional guidance and training to managing authorities on the identified risks, timely implementation of financial corrections, interruptions and suspensions procedures, and audits targeted on the most risky areas).

5.22. The Commission considers in this context that a sound management and control system is a system that allows certification of legal and regular expenditure.

5.23. Since the management and control system has a multi-annual character, an overpayment detected in a payment claim reimbursed by the Commission may not have been yet subject to the entire control chain at national and EU level at the time of certification. Therefore the Commission estimates each year the cumulative residual risk of irregular expenditure per programme since the beginning of the programming period and takes actions to mitigate the identified risks. When deficiencies are identified on management and control systems, the Commission takes appropriate action to ensure that all cumulative expenditure concerned is covered by the necessary financial corrections.

## THE COURT'S OBSERVATIONS

**Audit scope and approach**

5.25. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of regional policy, transport and energy, the following specific points should be noted:

- (a) the audit involved examination of a sample of 180 transactions<sup>(9)</sup> as defined in, **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of transactions within the policy areas. In 2012, the sample consisted of payments to projects in 17 Member States<sup>(10)</sup>;
- (b) the assessment of systems examined:
  - (i) four audit authorities (and, where applicable, delegated audit bodies) for the three cohesion policy funds (i.e. the ERDF, CF and ESF) in the 2007-2013 programming period in four Member States: Belgium (Wallonia), Malta, Slovakia and the United Kingdom (England)<sup>(11)</sup>;
  - (ii) the Commission's supervisory activities of AAs as a whole; and
  - (iii) the annual activity reports (AARs) of Directorate-General for Regional and Urban Policy, Directorate-General for Mobility and Transport and Directorate-General for Energy.

<sup>(9)</sup> This sample comprises 180 transactions related to 168 regional policy projects (138 ERDF and 30 CF), 9 transport and 3 energy projects (see **Annex 5.1**). Of the 168 regional policy transactions to ERDF/CF projects, the 145 relate to the 2007-2013 programming period and 23 to the 2000-2006 period. The sample was drawn from all payments, with the exception of advances which amounted to 1,9 billion euro in 2012.

<sup>(10)</sup> Belgium, Czech Republic, Germany, Greece, Spain, France, Italy, Luxembourg, Hungary, the Netherlands, Austria, Poland, Portugal, Romania, Slovakia, Finland, and the United Kingdom.

<sup>(11)</sup> This is part of an examination of AAs which started in 2010 (see the 2010 annual report, paragraphs 4.37 to 4.44) and continued in 2011 (see the 2011 annual report, paragraphs 5.35 to 5.51). Overall, 19 AAs in 15 Member States have been audited between 2010 and 2012.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**REGULARITY OF TRANSACTIONS**

5.26. **Annex 5.1** contains a summary of the results of transaction testing. Out of the 180 transactions audited by the Court, 88 (49 %) were affected by error. On the basis of the errors which it had quantified, the Court estimates the most likely error to be 6,8 % <sup>(12)</sup>.

**For more than half of the regional policy transactions, checks at Member State level could have prevented some of the errors found**

5.27. For 56 % of the regional policy transactions affected by error (quantifiable and/or non-quantifiable), the Court considers that sufficient information was available for the Member State authorities to have detected and corrected one or more of the errors before certifying the expenditure to the Commission.

5.28. As last year, for ERDF and CF, weaknesses in verifications by national authorities were detected in particular in the 'first level checks' carried out by managing authorities and intermediate bodies <sup>(13)</sup>.

**5.26.** The Commission notes that the 2012 most likely error rate is in line with the error rates presented by the Court for the three last years in relation with the current programming period. This decrease in the error rate compared to previous periods results from the reinforced control provisions in the 2007-2013 programming period and application of a strict policy of interruptions/suspensions by the Commission when deficiencies are identified. The Commission will continue to focus its actions on the most risky programmes and/or Member States and to impose swift corrective measures when deficiencies are identified (see also replies to paragraphs 1.12 and 1.13).

Moreover, the Commission made in 2012 flat rate corrections on a cumulative basis to all expenditure in two programmes in the Czech Republic and in Slovakia. The Commission notes that whilst it has done everything within its powers and acted in full respect of the existing regulations in order to protect the EU budget within the same financial year audited by the Court, the above flat rate corrections have not been taken into account by the Court when calculating the 2012 error rate.

The Commission also notes the decrease in the frequency of errors in 2012 to 49 % as compared to 59 % in 2011.

**5.27 and 5.28.** The Commission is strictly following up these cases to ensure that the concerned systems better prevent errors before certification in the future.

Managing authorities are required to perform documentary checks on all claims submitted by beneficiaries, before certification of expenditure. However, on-the-spot verifications on operations may also intervene at a later stage of project implementation, after certification and up to closure phase, which explains why part of the errors in the Court's sample could not be detected. The impact of the control system in reducing error rates is usually only seen in subsequent years, after all layers of controls have been implemented.

<sup>(12)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 3,7 % and 9,9 % (the lower and upper error limits respectively).

<sup>(13)</sup> See the 2011 annual report, paragraph 5.30.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Being aware of the critical role of the management verifications, the Commission is carrying out since 2010 targeted audits on management verifications of high risk programmes where it has identified that deficiencies could remain undetected or not timely detected. Results of these audits by end 2012 are presented in DG Regional and Urban Policy's AAR (see page 39).*

5.29. The errors found in the ERDF/CF, transport and energy policy areas concerned either:

- (a) failures to comply with public procurement rules; or
- (b) declaration of ineligible costs; or
- (c) incorrect calculation of the financing gap for revenue-generating projects; or
- (d) non-compliance with State aid rules.

**Failures to comply with public procurement rules account for more than half of the error rate estimated by the Court for these policy areas**

5.30. Public procurement rules are a key instrument for spending public money economically and effectively and for establishing an internal market within the EU.

5.31. In 2012, the Court examined 247 public procurement procedures related to contracts for works and services underlying the expenditure for the 180 transactions tested by the Court <sup>(14)</sup>. The combined estimated contract value for the public procurements that were audited amounts to approximately 6,3 billion euro <sup>(15)</sup>.

<sup>(14)</sup> For more than half of the 247 public procurement procedures audited by the Court the contract value was above the threshold which made them subject to EU public procurement rules as transposed into national law.

<sup>(15)</sup> This amount represents the total expenditure for the contracts awarded, part of which has been certified under the audited expenditure declarations.

## THE COURT'S OBSERVATIONS

5.32. As in previous years, public procurement procedures were particularly prone to error<sup>(16)</sup>. The Court identified instances of non-compliance with EU and/or national public procurement rules in 31 % of the 180 transactions audited.

5.33. Serious failures to comply with these rules were identified in 12 % of the transactions audited (see box 5.1). These errors account for 51 % of all quantifiable errors and make up approximately 52 % of the estimated error rate for these policy areas.

**Box 5.1 — Examples of serious failures to comply with public procurement rules**

- (a) *Artificial division of works into several tenders:* In an ERDF project in Germany for the upgrading of a sea port, works for the renovation of the ferry terminal were split into three sections. However, all sections fulfilled the same technical and economic function. The works were then split artificially into six contracts of which five were awarded using a simplified procedure. In view of the nature of the works tendered, this restriction of competition was not justified.

A similar case was found in an ERDF project in Poland.

## THE COMMISSION'S REPLIES

5.32. Public procurement errors relate to non-compliance with internal market's rules and are not specific to cohesion policy, as shown in other chapters of this report. In any event, the Commission continues to take targeted actions to prevent and detect cases of non-compliance with public procurement procedures. It is currently revising and harmonising in the area of shared management its rules for the application of flat rate corrections in such cases of non-compliance.

5.33. The Commission notes that errors identified in 22 projects out of 180 audited account for more than half of the calculated error rate. The Commission underlines that out of these projects, there are two cases where the Commission considers that the error identified by the Court has already been covered by a flat rate financial correction applied by the Member State at programme level in 2012 (see also reply to paragraph 5.26).

The Commission applies flat-rate corrections in Cohesion policy, based on the COCOF guidelines<sup>(1)</sup>, thereby protecting the EU budget taking into account the principle of proportionality and the nature and gravity of the actual irregularities identified.

These flat rates are applied by the Commission and by national authorities when imposing financial corrections for infringements of public procurement rules, including when following up the errors reported by the Court.

<sup>(16)</sup> See the 2010 annual report, paragraphs 4.26 to 4.27, and the 2011 annual report, paragraphs 5.31 to 5.33.

<sup>(1)</sup> Guidelines for determining financial corrections to be made to expenditure co-financed by the structural funds or the cohesion fund for non-compliance with the rules on public procurement, COCOF note 07/0037/03 of 29 November 2007.

## THE COURT'S OBSERVATIONS

- (b) *Unjustified direct award:* In a TEN-T project in France concerning the construction of a high-speed railway line, two civil engineering contracts were directly awarded to the same company that had previously provided similar services to the infrastructure manager. However, such a direct award was not in line with the applicable procurement rules and the contract should have been put out to tender.

Similar cases of unjustified direct awards were found in ERDF projects in Poland.

- (c) *Irregular award of a contract due to incorrect application of award criteria:* In an ERDF project in the United Kingdom for the expansion of a university and for the supply of a bio demonstrator facility, the contract was divided into two lots. During the evaluation stage, however, both lots were jointly evaluated, altering the outcome of the tender. As a result, the contract was awarded in an irregular manner.

A similar case was found in an ERDF project in Hungary.

## THE COMMISSION'S REPLIES

5.34. Other errors relating to tendering and contracting procedures occurred in a further 19 % of the 180 transactions examined. These errors include cases of non-compliance with information and publication requirements, shortcomings in the tender specifications and procedural weaknesses in the evaluation of bids. These errors do not contribute to the error rate estimated by the Court (see paragraph 5.26) <sup>(17)</sup>.

**Ineligible costs declared for 9 % of all projects audited by the Court**

5.35. When declaring costs to the Commission, national authorities are certifying that these costs have been incurred in compliance with a number of specific provisions laid down in EU regulations, national eligibility rules, specific OP rules, calls for interest, decisions approving projects for co-financing, or grant agreements.

**5.34.** *The Commission will follow-up all errors reported by the Court and will apply financial corrections where appropriate and legally possible, in accordance with its guidance (see reply to paragraph 5.33).*

<sup>(17)</sup> Further information regarding the Court's approach to the quantification of public procurement errors is set out in **Annex I.1**, paragraphs 9 to 11.



## THE COURT'S OBSERVATIONS

5.36. The Court found that ineligible costs had been declared in 9 % of the transactions examined. These account for 39 % of all quantifiable errors and make up approximately 19 % of the estimated error rate for these policy areas (see box 5.2).

## THE COMMISSION'S REPLIES

**5.36.** The Commission points out the importance that beneficiaries and programmes' managing authorities apply consistently the eligibility rules. This can be done through training and guidance and, for regional policy, managing authorities should carry over this knowledge acquired via training and guidance to all bodies in charge of managing the funds. For regional policy, when the Commission identifies complex rules at programme level, it also makes recommendations to the Member State concerned to simplify the rules.

The Commission will continue to focus its actions on programme authorities where risks have been identified. With a view to the 2014-2020 programmes, the Commission will make recommendations to the Member State to simplify the programmes' eligibility rules and to make effective use of simplified cost options foreseen in the regulations.

**Box 5.2 — Examples of declared ineligible costs**

- (a) *Expenditure declared outside the eligibility period:* In a TEN-T project in Finland for the production of a construction plan for a motorway bypass six invoices that had been incurred before the start of the eligibility period were included in the expenditure declaration. This expenditure was incorrectly certified as eligible to the Commission.

Similar cases of expenditure that was ineligible because the eligibility period had not been observed were found in ERDF projects in France and Austria.

- (b) *Excessive management fees:* In an ERDF project in the United Kingdom for a fund providing grants and loans to social enterprises with limited financial capability, salaries and other expenses were wrongly included in the cost claim as staff costs, instead of a management fee being claimed (calculated as a percentage of the direct costs) as provided for in the EU regulations. This resulted in an overcharging of expenditure in the cost claim.

## THE COURT'S OBSERVATIONS

**Incorrect calculation of the financing gap detected in almost 8 % of the transactions examined by the Court**

5.37. Under the ERDF and the CF, the amount of EU assistance to be granted to a project depends on the project investment cost and on the estimated net revenue which it will generate. Therefore, for revenue-generating projects<sup>(18)</sup>, future revenues and investment costs have to be analysed before the project is approved: the investment cost less the net revenues expected to be generated by the project over a specific reference period together with its residual value determine the 'financing gap'.

5.38. The Court found cases of revenue-generating projects where the financing gap had been incorrectly assessed. In those cases, potential income from the investment had not been taken into account or unrealistically high cost estimates had been used. Also, residual values might not have been taken into account. These problems were not detected by the managing authorities when they approved the project for co-financing and/or authorised payments to the project.

5.39. An over-declaration of expenditure due to an incorrect calculation of the financing gap was found in 1 % of the transactions audited. These account for 5 % of all quantifiable errors and make up approximately 5 % of the estimated error rate for these policy areas (see box 5.3). For a further 7 % of projects, errors are not quantified by the Court. This is because either the Commission guidance was not clear at the date of the approval of the project or the projects were not yet closed.

## THE COMMISSION'S REPLIES

**5.38 and 5.39.** For the non-quantifiable errors, the Commission underlines that:

- there is one case where it does not consider reimbursement from the national health system to constitute revenue for the purpose of calculating the financing gap,
- for Cohesion Fund projects of the 2000-2006 period co-funded before 2003, the regulation was requesting to take revenues into account but without referring to any particular method for this purpose, and was putting on an equal footing the need to also promote the polluter pays principle, which implied increased revenues for the concerned projects. In addition the regulation was referring to the need to develop such methods in cooperation with each concerned Member State. The methods applied before 2003 to take into account revenue, while promoting at the same time the polluter pays principle, may therefore differ from methods applicable today, without this constituting a breach of applicable rules.

<sup>(18)</sup> According to Article 55 of Regulation (EC) No 1083/2006: 'Revenue generating project means any operation involving an investment in infrastructure the use of which is subject to charges borne directly by users or any operation involving the sale or rent of land or buildings or any other provision of services against payment'.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Box 5.3 — Example of incorrect calculation of the financing gap for revenue generating projects**

*Unrealistic cost estimates used:* In a CF project in Portugal for the reconstruction of the drinkable water network of a city, the beneficiary overstated anticipated staff costs used in the Cost Benefit Analysis (CBA). This led to an overstated financing gap.

Similar cases where excessive costs were considered in the CBA were found in ERDF and CF projects in Spain, Poland and the United Kingdom.

**Non-compliance with State aid rules for 3 % of the projects**

5.40. State aid rules ensure that interventions by Member States do not distort competition and trade within the EU. Projects must comply with the provisions of these State aid rules <sup>(19)</sup>.

5.41. For 3 % of the 180 transactions audited, the co-financed projects did not comply with State aid rules. In those cases where the Court could establish that this contributed to an incorrect EU funding, the errors were quantified. These quantified errors account for 5 % of all quantifiable errors and make up approximately 9 % of the estimated error rate for these policy areas. Other cases of non-compliance with State aid rules, for which the impact on the EU funding could not be quantified at this stage, are not taken into account for the Court's error rate (see box 5.4). In 2011, a European Court of Justice ruling confirmed that State aid rules also apply to infrastructure projects which are to be run commercially <sup>(20)</sup>.

**5.41.** The Commission agrees that compliance with State aid rules is a condition for the eligibility of programmes. However, as in the Greek example provided below in box 5.4, the obligation to notify infrastructure projects was legally unclear until the 2011 ECJ Leipzig/Halle case-law (which was appealed with a final judgment only in 2013). In order to provide to Member States and beneficiaries clarification on the practical implications of the judgment, the Commission issued a guidance note in November 2012 and presented it to the COCOF. The Commission considers that in line with this guidance the absence of notification of infrastructure projects before November 2012 was not an irregularity.

<sup>(19)</sup> Article 107(1) on State aid of the Treaty on the Functioning of the European Union (TFEU).

<sup>(20)</sup> Case T-443/08 *Freistaat Sachsen und Land Sachsen-Anhalt v Commission* and T-455/08 *Mitteldeutsche Flughafen AG and Flughafen Leipzig-Halle GmbH v Commission*, judgment of 24 March 2011 and as upheld by the Court of Justice on 19 December 2012 in C-288/11P.

## THE COURT'S OBSERVATIONS

**Box 5.4 — Example of projects not in compliance with State aid rules**

*State aid not notified to Commission:* In an ERDF project in Greece for the construction of port facilities the aid constituted State aid <sup>(21)</sup>. The project was not notified to the Commission as required by Article 108 TFEU and therefore its compatibility with the internal market had not been assessed.

Similar cases were found in ERDF projects in Germany and the United Kingdom.

## THE COMMISSION'S REPLIES

**Errors found in the Commission's closure payments**

5.42. In previous years, the Court had noted that unreliable closure documentation (such as the winding-up declaration) may lead to irregular expenditure being unduly reimbursed unless the Commission takes appropriate action to detect and correct the underlying issues <sup>(22)</sup>.

5.43. This year's sample included closure payments to two OPs (Austria and Poland) and seven CF projects (Spain) from the 2000-2006 period for which in total 22 ERDF and CF projects were audited. The Court identified errors in 12 out of these 22 projects. For one ERDF OP, the Court found that not all expenditure in the closure payment was regular (Austria). However, the Commission closed this OP in 2012 without any financial correction. For the seven CF projects in Spain no financial corrections were imposed for the errors detected by the Court.

5.42. The weaknesses in winding up declarations had been identified and analysed by the Commission before the Court's audit, which intervened at an early stage of the closure process <sup>(2)</sup>. These weaknesses were addressed by the Commission during the subsequent steps of the closure process and additional audit work has been carried out after the initial assessment of the closure documents. Financial corrections were applied where appropriate.

5.43. The Commission will follow up the errors identified in the closed programme and notes that it can make financial corrections till three years after the formal closure of a programme when residual errors are detected.

The Commission has submitted to the European Parliament in April 2013 an overview report on financial corrections implemented by the Commission and reported by the Member States on programmes of the 2000-2006 period. The report informs that the corrections reached at least 5,6 % (EUR 7,3 billion) of the ERDF allocations for the programming period until 31 December 2012 (and 6,2 % or EUR 8,1 billion until 31 March 2013) <sup>(3)</sup>.

In relation to the 7 Cohesion Fund projects mentioned in the Court's observation, the Commission refers to its reply in paragraph 5.39 and further stresses that there were no breaches of the applicable legal framework justifying any financial correction.

<sup>(21)</sup> As defined by Article 107 TFEU.

<sup>(22)</sup> See the 2011 annual report, paragraphs 5.52 to 5.64.

<sup>(2)</sup> See 2011 annual report Commission reply to paragraphs 5.57 and 5.58.

<sup>(3)</sup> ARES (2013) 689652 of 12 April 2013 to the European Parliament and ARES(2013) 1044808 of 14 May 2013 to the European Court of Auditors.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**EFFECTIVENESS OF SYSTEMS****Audit authorities**

5.44. Within the 27 Member States, 112 AAs have been set up for the 434 OPs for the ERDF/CF and the ESF under the 2007-2013 programming period (see paragraphs 5.10 and 5.13 <sup>(23)</sup>).

5.45. In the cohesion area, the AA's ACRs and annual opinions provide information on the regularity of EU spending under the ERDF/CF and ESF for the 2007-2013 programming period <sup>(24)</sup>. In 2012, a total of 198 ACRs and annual opinions <sup>(25)</sup> were submitted to the Commission for the 317 ERDF/CF and 117 ESF OPs <sup>(26)</sup>.

**5.45.** The audit authorities play a central role in the assurance building process, as from the beginning of the programming period and set-up of systems. Thereafter, they report each year an audit opinion on the functioning of management and control systems to the Commission, based on audits on management and control systems and on samples of operations carried out, as a general rule, in accordance with an audit strategy. The regulation provides the Commission the possibility to rely on the work of an audit authority for its assurance under certain conditions (Article 73 of Regulation (EC) No 1083/2006).

The Commission is closely cooperating and coordinating with audit authorities, and has started reviewing their methodologies and audit results as early as 2009. This has contributed to capacity building by providing them with advice, guidance and recommendations through the Commission's re-performance work.

In their 2012 AARs, DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion analysed in detail the audit information and results reported by audit authorities in their 2012 ACRs (see pages 33 to 37 of DG Regional and Urban Policy's 2012 AAR and pages 35 to 39 of DG Employment, Social Affairs and Inclusion's 2012 AAR).

<sup>(23)</sup> 63 of these 112 AAs are responsible for auditing OPs for the ERDF/CF as well as the ESF within their Member State or a specific region. These 'multi-fund' AAs account for 344 of the 434 corresponding OPs and, in financial terms, audit the 89 % of the total budget (in terms of EU and national public and private funding).

<sup>(24)</sup> Each AA may produce one or more ACRs which in turn may relate to one or more OPs.

<sup>(25)</sup> The ACRs and annual opinions are based on the findings of the AAs' audits relating to expenditure certified to the Commission in the previous EU financial year (see Article 62(1)(d) of Regulation (EC) No 1083/2006).

<sup>(26)</sup> For 13 ERDF OPs, no ACRs and annual opinions for 2012 were provided by the AA by March 2013.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*The Court's examination of four AAs*

5.46. **Annex 5.2** contains the results of the individual key requirements tested and the overall assessment of the four AAs examined: Belgium (Wallonia), Malta, Slovakia and the United Kingdom (England). The Court paid particular attention to the ACRs and annual opinions and the parts of the AAs' work which had a direct and significant effect on their conclusions.

5.47. For each of the AAs examined the Court reviewed:

- (a) their organisational arrangements and audit methodology;
- (b) their working documents for two system audits;
- (c) their working documents for a sample of 20 audits of operations, including a re-performance of at least five of those 20 audits; and
- (d) their 2012 ACRs and annual opinions, together with the related working papers.

5.48. As in previous years, the Court found that organisational arrangements for all four AAs examined generally complied with EU regulations. This was also the case for the audit methodology used for the systems audit. However, the Court found weaknesses in the way the AAs carry out their audits of operations and systems and/or report the results thereof to the Commission <sup>(27)</sup>.

5.49. The Court assessed three of the four AAs to be 'partially effective' and one to be 'effective'. For the AAs assessed as 'partially effective' the Court considers that the ACRs were not fully compliant with the rules and/or the Court's re-performance of audits of operations had identified problems previously not detected by the AA.

**5.46.** Since the beginning of the current programming period, the Commission carried out 269 audit missions to fully or partially review the work of 41 ERDF/CF audit authorities covering 96 % of the ERDF/CF total allocation, and 84 ESF audit authorities covering 99 % of the ESF total allocation. This work included the four audit authorities audited by the Court. The Commission selected most audit authorities to be audited on the basis of an annually updated risk assessment which includes, among several risk criteria reviewed over time, programmes allocations.

**5.49.** Based on audit evidence gathered over several years, the Commission considers that it can rely on the work of these four well-functioning audit authorities for its assurance process (see also Commission replies to paragraphs 6.30 and 6.31).

<sup>(27)</sup> See the 2011 annual report, paragraph 5.43.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Assessment of the Commission's supervision of AAs*

5.50. In 2012, the Commission continued its enquiry into the reliability of the AAs' work and their compliance with EU regulations <sup>(28)</sup>. The Commission found similar shortcomings in the work of AAs to those observed by the Court (see paragraphs 5.48 and 5.49) or in the previous years <sup>(29)</sup>.

5.51. In addition, for each ERDF/CF and ESF OP, the Commission verified through desk review the information provided by the AAs in their ACRs and annual opinions <sup>(30)</sup>. If the Commission considers an error rate reported by an AA to be reliable and representative for the OP (or group of OPs) the Commission may accept it or, based on additional information, recalculate it. If the Commission regards a reported error rate to be unreliable, it applies a flat error rate (between 2 % and 25 %) depending on its risk assessment for the OP.

5.52. The Court's findings based on the information available at the Commission and additional data requested from AAs for all three funds (ERDF/CF and ESF) were as follows <sup>(31)</sup>:

**5.50.** *The Commission refers to its reply to paragraph 5.46 where it informs about the audit missions carried out in the area of cohesion policy since 2009. The enquiry on audit authorities remains the main enquiry under the current Commission's audit strategy. DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion continue their audit work with another 102 audit missions until mid-2014.*

**5.51.** *The Commission underlines that the analysis of ACRs and audit opinions constitute a key part of the assurance building process supporting the internal control declaration in the AAR in which it reports on the results of its analysis (see for example DG Regional and Urban Policy 2012 AAR, pages 33-35 and Annex 9 and DG Employment, Social Affairs and Inclusion 2012 AAR, pages 35-38 and Annex 8).*

*With respect to the reliability and representativeness of reported error rates, see reply to paragraph 5.52, second indent.*

**5.52.**

<sup>(28)</sup> Overall, since 2009, 62 of the 112 AAs have been examined by DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion. These AAs are in charge of 257 of the 317 ERDF/CF OPs and 48 of the 117 ESF OPs. The AAs examined during the four years represent 95 % of the ERDF/CF and 55 % of the ESF budget (in terms of EU and national public and private funding) for the 2007-2013 programming period.

<sup>(29)</sup> See the 2010 annual report, paragraph 4.42, and the 2011 annual report, paragraph 5.45.

<sup>(30)</sup> In specific cases, this desk review is complemented by on-the-spot visits to AAs to obtain additional information.

<sup>(31)</sup> The Court checked for 138 ERDF/CF and ESF OPs whether the Commission's validation of error rates reported by AAs was effective in verifying the accuracy and reliability of the information provided by AAs. These OPs are under the responsibility of 27 of the 62 AAs for which the Commission has carried out a specific enquiry during the last three years (see paragraph 5.50).



## THE COURT'S OBSERVATIONS

- The Commission's scope for validating and where necessary adjusting error rates included by AAs in their ACRs is limited since the AAs are not required to provide the Commission with information about their audits of operations <sup>(32)</sup>.

- For 51 of the 138 of the OPs reviewed the Court found that the Commission did not have sufficient information to accept (or recalculate) the error rates reported by the AAs when assessing the ACR. This includes cases where the audited expenditure stated in the ACR did not fully correspond to the OP's spending of the year or where the error rates reported in the ACR were not accurately calculated by the AA.

## THE COMMISSION'S REPLIES

- The Commission analyses at the beginning of each year all ACRs and audit opinions submitted by the national audit authorities. In addition, it takes into account all national audit results received from the audit authorities throughout the year, as well as other Commission and Court audit results. To further improve the reliability of the reported error rates and on the basis of doubts or risks identified, in 2013 the Commission services carried out fact finding missions on the spot for the ERDF/CF (11 missions in 9 Member States) and for ESF (15 Member States), to collect further evidence and to obtain clarifications on the submitted ACRs, in particular on the methodology for calculating the error rates. In some cases, the missions provided a sound basis for a recalculation of the error rates. The Commission also requested additional information in writing to some audit authorities, which provided it.

*The result of this analysis is a key source of the assurance building process, as explained in the AARs.*

*In doing so, the Commission accumulated an extensive knowledge of risks related to each audit authority.*

- The Commission notes that the 51 programmes quoted by the Court correspond to the work of 9 audit authorities out of the total of 112 audit authorities in charge of ERDF, ESF and CF. It also notes that the technical issue raised in the case of the 31 French programmes does not modify the audit authority's and the Commission's assessment.

*The Commission underlines that flat rates were applied where appropriate when the reported error rates were assessed by the Commission as unreliable. For the 14 programmes where no flat rate was applied, the Commission assessed the reported error rate as reliable and notes that the use of sample error rates based on non-statistical samples are foreseen in the regulation in the case of small populations of operations.*

*These are the only available indicators to estimate the overall risk for the concerned programmes and are therefore used by the Commission for the purpose of the assurance process. In such cases, the Commission also takes into account the characteristics of the population and the audit coverage. The Commission has actively promoted the use of statistical sampling in 2012/2013 and has updated its sampling guidance in April 2013 to allow the use of statistical sampling even in the case of small populations of operations, so as to obtain representative results.*

<sup>(32)</sup> See also the 2011 annual report, paragraph 5.50.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- For 16 of the 138 OPs, AAs reported non-representative error rates (i.e. rates which are neither based on a statistical nor on a formal non-statistical sampling approach in accordance with the Commission's guidance). Such rates should not be used by the Commission in its assurance process in view of projecting the error rate to the OP as a whole. The Court found that only for two out of these 16 OPs, flat rates were applied by the Commission as required.

- For five out of the 138 OPs, the error rate recalculated by the Court (taking account of the multiannual financial corrections) is above 2 %.

In the context above it is important to note that when the Commission validates the rates reported by the audit authorities, it uses all audit procedures in place when doubts arise as to the accuracy and/or reliability of reported error rates: written and oral questions to audit authorities, fact-finding missions and/or analysis of additional information from the audit authorities, including individual audit results if necessary. Based on this information, the error rates reported in the ACRs were adjusted in 21 % of the ERDF/CF and 15,4 % of the ESF programmes. Furthermore, the reported error rates for 11 % of the ERDF/CF and ESF programmes were considered as unreliable and therefore replaced by flat rates by the Commission (see 2012 AARs, page 35 for DG Regional and Urban Policy and page 37 for DG Employment, Social Affairs and Inclusion).

For further clarifications concerning the reported error rates of the audit authorities regarding the ESF, the Commission refers to its reply to paragraph 6.40(a).

- The Commission welcomes the fact that the Court has come to the same conclusions for all but five out of the 138 cases reviewed. These cases concern two audit authorities. Regarding these five cases, the Commission disagrees and confirms its assessment as reported in the 2012 AAR after an in-depth analysis of explanations provided by the concerned audit authorities.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*In particular, in the case of four Dutch programmes regrouped in a single sample, the Commission considered that a project where an error was detected by the audit authority and through its own audit in 2012 was of an exceptional nature and should not have been selected for funding. The national authorities accepted to withdraw the expenditure related to the entire project and thus the related irregular expenditure in late 2012. Therefore the Commission considers that this expenditure does not have to be included in the calculation of the projected error rate. For the German programme, the Commission considers that taking into account the part of the expenditure that was excluded from the population to be audited would have had a very limited impact on the error rate.*

*The Commission therefore considers that it has correctly implemented its supervisory role on the error rates reported by the audit authorities.*

**Review of the Commission's annual activity reports**

5.53. The Court assessed the 2012 AARs and accompanying declarations of the Directorates-General for Regional and Urban Policy, for Mobility and Transport, and for Energy. In particular, with regard to the regularity of payments authorised during 2012, the Court:

- (a) assessed the reservations made for 2012; and
- (b) checked the consistency and accuracy of the Commission's calculation of the amounts at risk.

*Directorate-General for Regional and Urban Policy*

5.54. In its 2012 AAR, the Directorate-General for Regional and Urban Policy estimated that between 2,2 % and 5,0 % of the interim and final payments for the ERDF and CF 2007-2013 programming period authorised during 2012 were at risk of error<sup>(33)</sup>.

5.55. This estimate, calculated by the Directorate-General for Regional and Urban Policy in its 2012 AAR is based on error rates reported by AAs in relation to 2011 expenditure<sup>(34)</sup>. This is above the 2 % materiality threshold set by the Commission and is in line with the assessment presented by the Court for this policy area for 2011<sup>(35)</sup>.

**5.55.** The Commission agrees that the level of risk presented in DG Regional and Urban Policy's 2012 AAR is comparable to the Court's results in its 2011 annual report.

<sup>(33)</sup> For 2011, the Directorate-General for Regional and Urban Policy estimated the risk to interim and final payments to be between 3,1 % and 6,8 %.

<sup>(34)</sup> According to sectorial regulations, AAs reported error rates to the Commission in December 2012 based on expenditure declared during 2011.

<sup>(35)</sup> See the 2011 annual report, paragraph 5.28.

## THE COURT'S OBSERVATIONS

5.56. The number of OPs subject to reservation by the Directorate-General for Regional and Urban Policy and their estimated financial impact decreased in 2012 compared to 2011 <sup>(36)</sup>. This is mainly due to a lower amount at risk estimated by the Commission on the basis of the error rates reported by AAs in their 2012 ACRs.

5.57. The Court considers that Directorate-General for Regional and Urban Policy should have issued a reservation for five additional OPs (see paragraph 5.52).

5.58. When assessing OPs, Directorate-General for Regional and Urban Policy also considers figures on multiannual cumulative residual risk (which is calculated by the Commission and takes account of financial corrections implemented at EU and national level since the start of the programming period). However, the Commission has only limited information as to whether the systems put in place by Member States for imposing financial corrections are effective. This carries the risk that the Commission's assessment of the individual OPs in the AAR is not sufficiently robust.

5.59. The approach taken by the Court to take account of the financial corrections in its audits is described in chapter 1, paragraphs 1.19 to 1.35.

## THE COMMISSION'S REPLIES

**5.56.** As indicated in the executive summary of DG Regional and Urban Policy's 2012 AAR, the decrease in the number of reservations is mainly due to the corrective actions taken in the Member States and the implementation of financial corrections by the Commission (see 2012 AAR pages 46 to 49). The strict policy followed by DG Regional and Urban Policy on warnings, interruptions, suspensions and financial corrections has worked as an incentive to improve the management and control systems.

**5.57.** The Commission refers to its reply to paragraph 5.52, which confirms that there was no reason for a reservation in any of the five cases. For four of these programmes regrouped in a single sample, the error was corrected in 2012 and therefore it does not have to be included in the calculation of the projected error rate. For the fifth programme the Commission considers that taking into account the part of the expenditure that was excluded from the population to be audited would have had a very limited impact on the error rate.

**5.58.** Since 2011, the Commission services have been carrying out at the request of the discharge authority risk-based audits on the systems for registering and reporting financial corrections. As a result, it has each year increased information about the functioning of the systems in Member States and requested an improvement of the corresponding systems where necessary (see synthesis report sent to the discharge authority and the European Court of Auditors in 2013) <sup>(4)</sup>. Moreover, the audit authorities carry out themselves audits of the activities of the certifying authorities and report results to the Commission, which takes account of this information in its assessment.

**5.59.** The Commission has taken all the necessary measures under the Treaty and foreseen in the regulations to protect the EU budget.

The Commission notes that, whilst it has done everything within its power and acted in full respect of the existing regulations within the same financial year audited by the Court, the flat-rate corrections applied to the Czech and Slovak programmes have not been taken into account when determining the 2012 error rate.

See Commission replies to paragraph 5.26 and box 1.2.

<sup>(36)</sup> The number of OPs under reservation decreased from 146 in 2011 to 85 in 2012. These figures include fully and partially quantified reservations for OPs for which interim and/or final payments were authorised during the year (121 in 2011 and 61 in 2012) and for OPs for which no such payments were made (25 in 2011 and 24 in 2012). In addition to the 85 reservations mentioned earlier, the Directorate-General for Regional and Urban Policy has issued reservations for four OPs under the IPA programme. In 2011, two reservations were issued in relation to the IPA Programme.

<sup>(4)</sup> ARES (2013) 5521 of 4 January 2013.

## THE COURT'S OBSERVATIONS

*Directorate-General for Mobility and Transport, and  
Directorate-General for Energy*

5.60. The Directorate-General for Mobility and Transport and the Directorate-General for Energy:

- made reservations covering 23 % and 57 % respectively of the total payment appropriations authorised during the year,
- estimated that approximately 4,6 % of payments authorised during 2012 in relation to the Sixth and the Seventh Framework Programmes (FPs) for research and technological development were affected by errors, and
- on the basis of the residual error rate these Directorate-Generals estimate the impact of their reservations at 2,5 % of the payments for research FPs made in 2012.

5.61. In 2012, the Court found quantifiable errors in six out of eight TEN-T projects audited (75 %). However, no reservation in relation to non-compliance with EU and national public procurement rules has been issued by the Directorate-General Mobility and Transport for the TEN-T programme. The Court also notes that the Directorate-General for Energy made such a reservation for the EEPR programme where similar problems had been identified by the Court <sup>(37)</sup>.

## THE COMMISSION'S REPLIES

5.61. The Commission considers that the Directorate-General for Mobility and Transport (DG Mobility and Transport) has followed the standing instructions for 2012 AARs (Reference Ares(2012) 1240233, point 7.4) in this respect and that there were no reasons for a reservation for the TEN-T programmes. In the context of its supervisory responsibilities over the trans-European Transport Network Executive Agency (TEN-T EA), DG Mobility and Transport took into account all the information at its disposal including the 2011 Court of Auditor's report and the assurances given by the Agency.

For the latter, it can be noted that the error rate detected by finalised ex post controls at 31 December 2012 was 1,7 %, below the materiality threshold of 2 %. Furthermore the Agency had taken a series of measures in 2012 taking into account the Court's findings to strengthen its controls and raise beneficiaries' awareness on public procurement rules.

At the time of issuing its reservation, by 31 March 2013, DG Mobility and Transport had received three Preliminary Findings from the Court concerning public procurement errors in TEN-T projects, two of which had been analysed and contested by DG Mobility and Transport in February 2013.

<sup>(37)</sup> See the 2011 annual report, paragraph 5.69(b).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**CONCLUSION AND RECOMMENDATIONS****The conclusion for 2012**

5.62. For the policy areas covered by this chapter,

- testing of transaction indicates that the most likely error present in the population is 6,8 %, and

- the examined supervisory and control systems are assessed as partially effective <sup>(38)</sup>.

**5.62.**

- The Commission notes that the most likely error rate is in line with the error rates presented by the Court for the three last years in relation with the current programming period.

*This decrease in the error rate compared to previous periods results from the reinforced control provisions in the 2007-2013 programming period and application of a strict policy of interruptions/suspensions by the Commission when deficiencies are identified. The Commission will continue to focus its actions on the most risky programmes and/or Member States and to impose swift corrective measures when deficiencies are identified (see also replies to paragraphs 1.12 and 1.13).*

*Two programmes including errors identified by the Court in its 2012 sample (in the Czech Republic and Slovakia) were corrected in 2012 at flat rate. The Commission notes that, whilst it has done everything within its power and acted in full respect of the existing regulations in order to protect the EU budget within the same financial year audited by the Court, the above flat rate correction has not been taken into account by the Court when calculating the 2012 error rate.*

- The Commission considers that it has a thorough supervisory process in place in order to ensure the overall reliability of the work of the audit authorities for its own assurance.

*Since the beginning of the current programming period, the Commission carried out 269 audit missions to fully or partially review the work of 41 ERDF/CF audit authorities covering 96 % of the ERDF/CF total allocation, and 84 ESF audit authorities covering 99 % of the ESF total allocation.*

*Based on its assessment, the Commission underlines that the effectiveness and compliance of audit authorities with the requirements may vary. In accordance with Article 73 of Regulation (EC) No 1083/2006, the Commission is, as from the first half of 2012, formally relying on the work of 15 audit authorities for ERDF/CF (for 51 programmes). The Commission will continue to review the work of audit authorities.*

<sup>(38)</sup> See Annex 1.1, paragraph 17.

## THE COURT'S OBSERVATIONS

5.63. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

**Recommendations**

5.64. The result of the Court's review of progress in addressing recommendations made in previous annual reports is presented in **Annex 6.2** as part of chapter 6.

5.65. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission:

- **Recommendation 1:** addresses weaknesses in 'first level checks' carried out by managing authorities and intermediate bodies for the ERDF and the CF, through specific guidance material and, where appropriate, through training measures,

## THE COMMISSION'S REPLIES

**5.63.** The Commission has taken specific actions in order to mitigate the risks identified, which include in particular preventive and corrective measures such as guidance, training, simplification in addition to a strict policy on interruptions/suspensions of payments and financial corrections.

**5.64.** See Commission reply to paragraph 6.42 and to Annex 6.2.

**5.65.**

The Commission agrees on the importance of the 'first level' checks conducted by the Member States and shares the view that these should be further strengthened. It has already been giving guidelines to the Member States on the way managing authorities should define and implement their management verifications.

Moreover, the Commission developed in 2009 comprehensive guidelines for the first level checks and a self-assessment tool for managing authorities, which they can use to improve their functioning. The Commission has also disseminated in 2011 to audit authorities its checklists for the audit of management verifications which can be used by the managing authorities themselves, as a benchmark. Specific training was delivered to managing authorities who are responsible to disseminate further this training material to all levels of projects management involved. The Commission will continue to carry out capacity building actions in this respect.

Finally, the Commission is carrying out since 2010 targeted audits on management verifications of high risk programmes where it has identified that deficiencies could remain undetected or not timely detected. Results of these audits by end 2012 are presented in DG Regional and Urban Policy's AAR (page 39).

## THE COURT'S OBSERVATIONS

- **Recommendation 2:** on the basis of its experience gained of the 2007-2013 programming period, carries out an assessment of the use of national eligibility rules in view of identifying possible areas for further simplification and eliminating unnecessary complex rules ('gold-plating'),
- **Recommendation 3:** specifies clear rules and provides robust guidance on how to assess the eligibility of projects and calculate the co-financing for revenue-generating ERDF and CF projects under the 2014-2020 programming period, and
- **Recommendation 4:** seeks improvement in the work done by audit authorities and the quality and reliability of the information provided in ACRs and audit opinions.

## THE COMMISSION'S REPLIES

*The Commission fully shares the need to further simplify national eligibility rules and eliminate unnecessary complex rules, which have a detrimental impact in terms of the burden on beneficiaries and increased error rate. Nonetheless, the Commission only partly accepts this recommendation as a systematic assessment of all national eligibility rules is not feasible. Whenever the Commission identifies complex rules at the level of the Member States it addresses them jointly with the Member States concerned. It will make recommendations to Member States for the next programming period and will encourage them to use simplified cost options offered in the draft regulations.*

*The Commission has recognised the need for improvement in this area and has taken actions accordingly. The regulatory framework for the 2014-2020 programming period includes simplifications in relation to eligibility rules in many respects and also lays down a simplified mechanism in respect of revenue generating projects.*

*The Commission agrees with the importance of this issue and underlines that the work of the audit authorities as reflected in the ACRs is one of the main elements on which the Commission builds its assurance. Further guidance on the treatment of errors and Commission checklists have already been provided to the audit authorities in 2011 and numerous seminars have been organised by the Commission in 2012 and 2013 in order to further improve the audit sampling methodology used in preparation of the ACRs. The Commission continues to work with audit authorities to provide further guidance, including on the reporting of audit findings (see page 87 of DG Regional and Urban Policy's 2012 AAR).*

## ANNEX 5.1

## RESULTS OF TRANSACTION TESTING FOR REGIONAL POLICY, ENERGY AND TRANSPORT

	2012					2011	2010	2009
	ERDF	CF	Energy	Transport	Total			
SIZE AND STRUCTURE OF THE SAMPLE								
Total transactions:	138	30	3	9	180	180	177	145
RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>								
Proportion (number) of transactions tested found to be:								
Free of error	54 % (75)	47 % (14)	33 % (1)	22 % (2)	51 % (92)	41 %	43 %	60 %
Affected by one or more errors	46 % (63)	53 % (16)	67 % (2)	78 % (7)	49 % (88)	59 %	57 %	40 %
Analysis of transactions affected by error								
Analysis by type of error								
Non-Quantifiable errors:	52 % (33)	75 % (12)	50 % (1)	14 % (1)	53 % (47)	64 %	60 %	60 %
Quantifiable errors:	48 % (30)	25 % (4)	50 % (1)	86 % (6)	47 % (41)	36 %	40 %	40 %
Eligibility	87 % (26)	75 % (3)	100 % (1)	100 % (6)	88 % (36)	94 %	97 %	78 %
Occurrence	3 % (1)	0 % (0)	0 % (0)	0 % (0)	2 % (1)	3 %	0 %	0 %
Accuracy	10 % (3)	25 % (1)	0 % (0)	0 % (0)	10 % (4)	3 %	3 %	22 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS								
Most likely error rate					6,8 %			
Upper Error Limit (UEL)					9,9 %			
Lower Error Limit (LEL)					3,7 %			

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.



## RESULTS OF EXAMINATION OF SYSTEMS FOR COHESION POLICY FUNDS (ERDF/CF/ESF)

## Assessment of selected supervisory and control systems: Audit authorities (AA) — compliance with key regulatory requirements and effectiveness in ensuring the regularity of operations

Key requirements tested by the Court		Belgium (Wallonia) AA for ERDF/ESF	Malta AA for ERDF/CF/ESF	Slovakia AA for ERDF/CF/ESF	United Kingdom (England) AA for ESF
General aspects	The set up of the management and control systems of the operational programme provides for an appropriate definition, allocation and separation of functions within the AA and between the AA and other competent management and control bodies	Compliant	Compliant	Compliant	Compliant
Audit manual coverage	Existence of audit manual (for both audits on systems and audits on operations), which is in accordance with internationally accepted audit standards and clearly describes the audit procedures	Compliant	Compliant	Compliant	Compliant
Audit methodology for systems audit	The audit work carried out by the AA to evaluate the effective functioning of the management and control system is based on a checklist that contains questions that verify key requirements of the applicable regulations (specified for MAs, IBs and CAs) and appropriate assessment criteria for each of these key requirements	Compliant	Compliant	Compliant	Compliant
Review of audits on systems	The AA's audit plan had been implemented in accordance with the approved audit strategy for the period, audits on systems were carried out in accordance with the methodology established by the AA and all phases of the audits on systems were properly documented	Effective	Effective	Effective	Effective

Key requirements tested by the Court		Belgium (Wallonia) AA for ERDF/ESF	Malta AA for ERDF/CF/ESF	Slovakia AA for ERDF/CF/ESF	United Kingdom (England) AA for ESF
Sampling methodology for audits of operations	An appropriate sampling methodology for audits of operations has been specified to draw the sample of operations to be audited for the period under review	Compliant	Compliant	Compliant	Compliant
Drawing of sample for audits of operations	The sampling methodology for audits of operations has been used as specified to draw the sample of operations to be audited for the period under review	Partially effective	Effective	Effective	Effective
Audit methodology for audits of operations	The audit work carried out to examine the regularity of operations is based on a checklist that contains questions that verify the requirements of the applicable regulation at a sufficient level of detail to address the associated risks	Compliant	Compliant	Compliant	Partially compliant
Review of audits of operations	The audits of operations had been implemented in accordance with the sample selected for the period, were carried out in accordance with the methodology established by the AA and all phases of the audits of operations were properly documented	Effective	Partially effective	Effective	Effective
Re-performance of audits on operations	A re-performance by the Court of the AA's audits of operations resulted in findings similar to those of the AA, as reported to the Commission	Effective	Partially effective	Effective	Partially effective

Key requirements tested by the Court		Belgium (Wallonia) AA for ERDF/ESF	Malta AA for ERDF/CF/ESF	Slovakia AA for ERDF/CF/ESF	United Kingdom (England) AA for ESF
Annual control report and audit opinion	The annual control report and audit opinion were established in accordance with the regulatory requirements and the guidance agreed between the Commission and the Member States, and the report and opinion are consistent with the results of the audits on systems and audits on operations carried out by the AA	Partially compliant	Partially compliant	Compliant	Compliant
Overall assessment <sup>(1)</sup>		Partially effective	Partially effective	Effective	Partially effective

<sup>(1)</sup> As for previous year examination of AAs (see the 2010 annual report, Annex 4.2; and the 2011 annual report, Annex 5.2), the following criteria are applied to obtain the overall assessment of the AA on the basis of the assessment of the specific key requirements tested:

- (a) **Effective**: the assessment of the key requirement 'Annual control report and audit opinion' is 'Compliant' and the assessments of the key requirements 'Review of audits on systems', 'Drawing on sample', 'Review of audits of operations' and 'Re-performance of audits on operations' are 'Effective'.
- (b) **Partially effective**: the assessment of the key requirement 'Annual control report and audit opinion' is at least 'Partially compliant' and the assessments of the key requirements 'Review of audits on systems', 'Drawing on sample', 'Review of audits of operations' and 'Re-performance of audits on operations' are at least 'Partially effective'.
- (c) **Not effective**: the assessment of the key requirement 'Annual control report and audit opinion' is 'Not compliant' or the assessments of at least one of the key requirements 'Review of audits on systems', 'Drawing on sample', 'Review of audits of operations' and 'Re-performance of audits on operations' is 'Not effective'.



## CHAPTER 6

**Employment and social affairs**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

6.1. This chapter presents the specific assessment of the policy area 'Employment and social affairs'. Key information on the activities covered and the spending in 2012 is provided in **Table 6.1**.

6.2. The 'Employment and social affairs' policy area is overwhelmingly financed through the European Social Fund (ESF), which is part of the cohesion policy funds together with the European Regional Development Fund (ERDF) and the Cohesion Fund (CF) and is governed by the same rules. Additional provisions for the ESF are set out in a specific regulation <sup>(1)</sup>. For issues common to all three funds, reference is made in this chapter to chapter 5.

**Table 6.1 — Employment and social affairs — key information 2012**

(million euro)

Policy area	Description	Payments	Management mode
Employment and social affairs	Administrative expenditure	11 281	Shared
	Employment, social solidarity and gender equality	120	Centralised direct
	Administrative expenditure	93	Centralised direct
	European Globalisation Adjustment Fund	83	Shared
	Working in Europe — Social dialogue and mobility	64	Centralised direct
	Instrument for Pre-Accession Assistance	58	Decentralised
		<b>11 699</b>	
	Total payments for the year	<b>11 699</b>	
	– total administrative expenditure <sup>(1)</sup>	93	
	Total operational expenditure	<b>11 606</b>	
	– advances <sup>(2)</sup>	146	
	+ clearings of advances <sup>(2)</sup>	1 944	
	<b>Audited population, total</b>	<b>13 404</b>	
	<b>Total commitments for the year</b>	<b>11 782</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 9.

<sup>(2)</sup> In line with the harmonised definition of underlying transactions (for details see chapter 1, paragraphs 1.6 and 1.7).

Source: 2012 consolidated accounts of the European Union.

<sup>(1)</sup> Regulation (EC) No 1081/2006 of the European Parliament and of the Council of 5 July 2006 on the European social fund and repealing Regulation (EC) No 1784/1999 (OJ L 210, 31.7.2006, p. 12).

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy area***Policy objectives*

6.3. The 'Employment and social affairs' policy area forms part of the EU cohesion policy, which aims to reinforce economic, social and territorial cohesion within the EU by reducing the gap in the level of development between regions. Specifically, the main objectives of EU employment and social policy are to combat unemployment, to develop human resources and to promote integration in the labour market.

*Policy instruments*

6.4. The ESF is the main tool for the implementation of employment and social policy, accounting for around 97 % of the policy area spending in 2012. The ESF funds investments in human capital through training to improve access to employment, including helping people from disadvantaged groups to get jobs and other employment measures (e.g. subsidising salary and/or social security costs for unemployed persons).

6.5. Other spending in this area takes the form of subsidies and grants to organisations implementing and coordinating social and employment actions. This includes funding provided to EU agencies <sup>(2)</sup>, for the European Globalisation Adjustment Fund (EGF) <sup>(3)</sup>, for the Instrument for Pre-Accession Assistance (IPA) <sup>(4)</sup> and for contributing to financial instruments such as the European Progress Microfinance Facility <sup>(5)</sup>.

<sup>(2)</sup> The European Institute for Gender Equality, the European Foundation for the Improvement of Living and Working Conditions, and the European Agency for Safety and Health at Work.

<sup>(3)</sup> The EGF supports workers in the EU made redundant as a result of major structural changes in world trade patterns and of the financial and economic crisis.

<sup>(4)</sup> Only payments for the human resources development component of the IPA are included under the 'Employment and social affairs' policy budgetary area. Amongst other things, the IPA supports candidate countries in preparing for the implementation and management of the ESF.

<sup>(5)</sup> The European Progress Microfinance Facility, launched in 2010, increases the availability of microcredit — loans below 25 000 euro — for setting up or developing a small business. The financial envelope for implementing these activities for the period from 1 January 2007 to 31 December 2013 was set at 683,25 million euro.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Management and control of spending**

6.6. ESF expenditure is subject to shared management by the Commission and the Member States. The ESF is governed by the management and control systems for cohesion spending as a whole, as described in chapter 5 (see paragraphs 5.9 to 5.14).

6.7. The EGF is also implemented through shared management. For EGF, the budgetary authority decides on the appropriations and, the Commission reviews the applications for funding submitted by Member States and approves the payments. The IPA instrument is implemented through decentralised management while the other social and employment expenditure is implemented under direct centralised management.

*Risks to regularity*

6.8. The main risks for ESF expenditure are related to the intangible nature of the investments in human capital (such as training courses), the diversity of the co-financed activities and the involvement of multiple, often small-scale, partners in the implementation of projects. These factors lend themselves to non-compliance with EU and/or national eligibility rules and legislation resulting in ineligible costs being accepted or calculation errors affecting the accuracy of claims, which are then not detected by the systems in place.

**6.8.** The Commission has taken specific actions in order to mitigate the risks identified, which include in particular preventive and corrective measures such as guidance, training, simplification and a strict policy on interruptions and suspensions of payments, when necessary. The Commission is also addressing this risk by actively promoting the use of simplified cost options by the Member States (see the Commissions replies to paragraphs 6.22 to 6.25).

**Audit scope and approach**

6.9. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of 'Employment and social affairs', the following specific points should be noted:

- (a) the audit involved examination of a sample of 180 transactions<sup>(6)</sup> as defined in **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of transactions within the policy area. In 2012 the sampled transactions contained payments (or clearings) to ESF projects within 21 operational programmes (OPs) in 15 Member States<sup>(7)</sup>, three EU agencies and other projects or actions managed directly by the Commission,

<sup>(6)</sup> For the ESF and IPA, the Court's sample contained 168 interim or final payments to projects. For EGF and other employment and social measures, 12 payments or clearings of expenditure were part of the sample.

<sup>(7)</sup> Belgium, Germany, Estonia, Greece, Spain, France, Italy, Lithuania, the Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia and the United Kingdom.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(b) the assessment of systems examined:

- (i) two audit authorities (AAs) for the 2007-2013 programming period in charge of managing ESF expenditure: United Kingdom (England) and Slovakia. This was part of the examination of a total of four audit authorities for the three cohesion policy funds (ERDF, CF and ESF) as indicated in chapter 5 (see paragraph 5.25),
- (ii) the Commission's supervision of AAs and in particular the assessment made by Directorate-General for Employment, Social Affairs and Inclusion (DG EMPL) of the reliability of the information and conclusions of annual control reports (ACRs) and audit opinions prepared by the AAs,
- (iii) the annual activity report (AAR) of DG EMPL.

## REGULARITY OF TRANSACTIONS

6.10. **Annex 6.1** contains a summary of the results of transaction testing. Out of the 180 transactions audited by the Court 63 (35 %) were affected by error. On the basis of the errors which it had quantified in 31 transactions, the Court estimates the most likely error to be 3,2 % <sup>(8)</sup>.

6.11. The results of the Court's audit indicate weaknesses in particular in the 'first level checks' of the expenditure, which aim to prevent, detect and correct irregularities and verify the actual implementation of projects. These checks are the responsibility of the managing authorities and intermediate bodies in the Member States.

**6.10.** The Commission refers to its reply to paragraph 1.12 in which it explains the implications of a multi annual framework for the implementation of operational programmes. As a consequence of the operation of its internal control system, the Commission has implemented financial corrections and recoveries for an amount of 442 million euro in the policy area of Employment and Social Affairs in 2012 (see in particular also the situation of Romania described in the Commission's reply to paragraph 6.39(a) and Box 1.2). The Commission notes the decrease in the frequency of errors detected by the Court in the policy area of Employment and Social Affairs in 2012 (35 %) as compared to 2011 (40 %).

**6.11.** Managing authorities are required to perform documentary checks on all claims submitted by beneficiaries, before certification of expenditure. However, on-the-spot verifications on operations may also intervene at a later stage of project implementation, after certification and up to closure, which explains why part of the errors in the Court's sample could not be detected yet by the management and control systems of Member States. The impact of these systems in reducing error rates is usually only seen in subsequent years, after all layers of controls have been implemented.

<sup>(8)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,3 % and 5,1 % (the lower and upper error limits respectively).

## THE COURT'S OBSERVATIONS

6.12. As in previous years, the Court considers that for 67 % of the transactions affected by error (both quantifiable and non-quantifiable) sufficient information was available for the Member State authorities to have detected and corrected at least one or more of the errors prior to certifying the expenditure to the Commission.

6.13. Most of the errors found in this policy area concerned either ineligible projects and expenditure, failures to comply with public procurement rules or the inclusion of ineligible participants in projects co-financed by the ESF.

**Ineligible projects and expenditure**

6.14. The Court detected ineligible projects or the reimbursement of ineligible costs and incorrectly calculated costs in 20 transactions, 11 % of the 180 transactions audited. 17 of these transactions related to ESF projects. Such errors account for 65 % of all quantifiable errors and make up approximately 72 % of the estimated error rate for this policy area (see box 6.1).

## THE COMMISSION'S REPLIES

**6.12.** The Commission is strictly following up these cases to ensure that appropriate action plans are implemented by the Member States concerned in order to prevent errors prior to certification of expenditure in the future. Furthermore, being aware of the critical role of the management verifications and the need to improve them, DG EMPL has sent in November 2012 a note to all Managing Authorities drawing their attention to the need to further strengthen the reliability and thoroughness of the management verifications and announcing a thematic audit on management verifications, to be conducted in 2013 on 7 selected OPs in 6 Member States. This thematic audit is currently underway. Once finalized, the Commission will prepare an overview report summarising its results and lessons learned to be shared with all Member States.

**6.14.** The errors identified by the Court in Romania account for a substantial part of the overall error rate in the policy area of Employment and Social Affairs. Similar errors had been previously identified by the Commission. Therefore, a 25 % flat rate financial correction at OP level has been implemented by the Commission in the course of 2012. See reply to paragraph 6.39(a) and to Box 1.2.

**Box 6.1 — Examples of ineligible projects and expenditure**

- (a) *Beneficiary not eligible for ESF funding:* Romanian law requires anyone providing professional training to be authorised. A project aiming at integrating inactive rural women into the labour market was implemented by a beneficiary not so authorised. The whole amount claimed was thus ineligible.
- (b) *Incorrectly calculated staff costs:* A project co-financed directly by the Commission aimed at strengthening trade union coordination of European Works Councils. The Court identified calculation errors of personnel costs representing 3,2 % of the audited amount.

## THE COURT'S OBSERVATIONS

- (c) *Incorrect allocation of overhead costs:* According to EU eligibility rules <sup>(9)</sup> overhead costs should be 'allocated pro rata to the operation, according to a duly justified, fair and equitable method'. In Spain the overhead costs for a training project were allocated using a method that did not fulfil these requirements. The Court considers that the overhead costs were overcharged by 2,3 % of the audited amount.

## THE COMMISSION'S REPLIES

**Breaches of public procurement rules**

6.15. Although the proportion of transactions with public procurement procedures is lower for employment and social affairs than for regional policy, transport and energy, the Court found breaches of EU and/or national public procurement rules in 24 of the 180 transactions audited. Serious failures to respect these rules were identified in nine cases, 5 % of the transactions audited and led to quantifiable errors. They account for 29 % of all quantifiable errors and make up approximately 26 % of the estimated error rate for this policy area.

6.16. In all cases, the amounts involved were below the level at which the EU procurement rules <sup>(10)</sup> would directly apply. Thus the rules breached were national rules (see box 6.2).

6.15. *The Commission applies proportionate flat rate corrections in Cohesion policy, based on the COCOF guidelines, thereby protecting the EU budget taking into account the principle of proportionality and the nature and gravity of the irregularities identified.*

*These flat rate corrections are applied by the Commission and by national authorities when imposing financial corrections for infringements of public procurement rules, including when following up all public procurement errors reported by the Court.*

6.16. *The Commission will follow up all errors reported by the Court and will apply financial corrections where appropriate and legally possible. The Commission notes that in some cases national or regional rules applied to ESF funded expenditure are more demanding than those foreseen in the national legislation for similar expenditure nationally funded. Therefore, these additional requirements can be seen as an instance of gold plating, self-imposing unnecessary administrative burden and complexity to ESF funded expenditure.*

<sup>(9)</sup> Commission Regulation (EC) No 448/2004 of 10 March 2004 amending Regulation (EC) No 1685/2000 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the eligibility of expenditure of operations co-financed by the Structural Funds and withdrawing Regulation (EC) No 1145/2003 (OJ L 72, 11.3.2004, p. 66).

<sup>(10)</sup> Directives 2004/17/EC and 2004/18/EC of the European Parliament and of the Council (OJ L 134, 30.4.2004).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Box 6.2 — Examples of breaches in public procurement rules**

- (a) *Incorrectly awarded contract:* In Italy a beneficiary carried out a procurement procedure for a package for travel and education services for a school trip. The beneficiary published the contract notice only on the school's notice board and not in any regional newspaper as required by national legislation. In addition, the time limit set for sending the bids was only three working days. These facts limited competition and restricted the access of potential bidders. As a result of this, the whole contract amount is considered ineligible. This represented 84,9 % of the costs audited within the declared claim. This project was part of a claim reimbursed after the Commission resumed payments to the OP following an interruption imposed by DG EMPL.

Similar findings of incorrectly awarded contracts were also identified in an ESF project in Romania.

- (b) *Unlawful direct award of contract:* in an ESF project in Estonia, services for accounting were contracted without any tendering in breach of national public procurement rules. The error represented 1,5 % of the audited amount.

Similar findings were also identified in ESF projects in France.

**Ineligible participants**

6.17. The Court found in two out of the 180 transactions audited that participants of ESF funded specific actions did not meet the eligibility criteria, leading to quantifiable errors. These cases represent 6 % of all quantifiable errors and make up approximately 2 % of the estimated error rate for this policy area (see box 6.3).

6.17. The Commission will follow up all cases identified by the Court in order to implement the necessary financial corrections. However, the requirements mentioned in the example shown in Box 6.3 are another instance of gold plating, being entirely self-imposed by the national eligibility rules, which do not take into account that such a long maintenance period is often not feasible. In this particular case, following Commission recommendations, the requirements and management of employment aids have been substantially improved in 2012.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Box 6.3 — Examples of ineligible participants**

*Ineligible participants:* ESF support was given to Spanish companies hiring unemployed persons. An eligibility condition for participants was that the employers had to maintain the newly employed staff for a minimum period of three or, in some cases, up to five years. This condition was not respected for 12 persons. The costs claimed for the ineligible participants were 39,2 % of the audited amount.

Similar findings were also identified in an ESF project in Italy.

**Numerous failures to observe procedural requirements**

6.18. Almost all the non-quantifiable errors found by the Court concerned various failures by managing authorities and beneficiaries to observe procedural requirements in the management and implementation of ESF projects. In eight cases, the failures are considered by the Court as serious issues of non-compliance. Box 6.4 gives examples of the main categories of non-quantifiable errors.

**6.18.** *The Commission will follow up all errors reported by the Court and ensure that corrective measures take place.*

**Box 6.4 — Examples of failures to observe procedural requirements**

(a) *A major change of the scope and objectives of a project without amendment of the grant agreement:* An ESF project in Slovakia co-financed training measures in two specific municipalities. The Court found that a large part of these measures were delivered to employees of a high school of a third municipality in another region. Although the beneficiary obtained written approval from the Intermediate body, a modification of this nature requires an amendment to the grant agreement. This was not done.

(b) *Contract award notice sent late or not sent at all:* According to public procurement rules contracting authorities must send a notice of the results of the award procedure no later than 48 days after the award of the contract. The Court found three cases in Greece where this rule was not observed.

Similar findings were also identified in ESF projects in the UK.

## THE COURT'S OBSERVATIONS

(c) *Incorrect use of state aid rules:* An ESF project in Portugal supported SMEs by subsidising the personnel costs of newly hired unemployed persons as trainees for 12 months. This kind of aid would be acceptable if it had been implemented as a 'de minimis' aid or under an exempted aid scheme. However, none of these two possibilities were implemented by the Member State.

Similar findings were also identified in an ESF project in Germany.

## THE COMMISSION'S REPLIES

### The impact of the use of simplified cost options (SCOs)

6.19. The Court recommended in previous annual reports that the Commission should extend the use of lump sum and flat rate payments instead of reimbursing 'real costs' in order to reduce the likelihood of error and the administrative burden on project promoters <sup>(11)</sup>.

6.20. In 2009, the legislator enlarged the number of SCOs <sup>(12)</sup>. Since then, costs for projects or operations implemented directly in the form of grants may be declared by using:

- a flat rate for indirect costs of up to 20 % of the direct costs of an operation,
- flat rate costs calculated by applying standard scales of units cost, or
- lump sums of up to 50 000 euro for all or a part of the costs of an operation.

6.21. Based on the results of a survey, the Commission estimates that around 60 % of ESF OPs used at least one of the three SCOs for declaring part of the costs reimbursed in 2012.

6.22. In the Court's sample, 43 transactions within 12 of the 21 OPs had cost declarations which included SCOs. 24 transactions had flat rate costs calculated by applying standard scales of unit costs and 15 transactions had flat rates for indirect costs. Less frequent was the use of lump sums (four transactions).

**6.19.** *The Commission has actively worked since the introduction of the simplified cost options to progressively extend their use and considers that these efforts have already led to positive results. The Commission will continue to actively promote the use of simplified cost options.*

**6.22.** *The Commission considers that the Court's observation confirms the impact of its continuous efforts to encourage Member States to effectively implement simplified cost options since the beginning of the current programming period, which have been significantly strengthened through specific simplification seminars conducted since 2011, involving to date 17 Member States.*

<sup>(11)</sup> 2006 annual report, paragraph 6.45 and 2007 annual report, paragraph 6.34.

<sup>(12)</sup> Regulation (EC) No 396/2009 of the European Parliament and of the Council of 6 May 2009 amending Regulation (EC) No 1081/2006 on the European Social Fund to extend the types of costs eligible for a contribution from the ESF (OJ L 126, 21.5.2009, p. 1).

## THE COURT'S OBSERVATIONS

6.23. The Court did not detect any errors (quantifiable or non-quantifiable) related to the specific use of SCOs. This indicates that projects whose costs are declared using SCOs are less error prone. Thus a more extensive use of SCOs would normally have a positive impact on the level of error.

6.24. One of the main barriers to the implementation of SCOs by managing authorities and intermediate bodies is the fear of establishing rates that would not meet the requirements of Article 11(3) of Regulation (EC) No 1081/2006<sup>(13)</sup>, i.e. rates 'shall be established in advance on the basis of a fair, equitable and verifiable calculation'. The Commission has issued guidelines on how these requirements should be understood<sup>(14)</sup>. These guidelines are clear and provide good illustrative examples and together with the active promotion of SCOs and a systematic ex ante approval by the Commission of the flat-rates calculated, will likely extend their use by managing authorities and intermediate bodies. This is particularly relevant in view of the current preparatory stage for the upcoming 2014-2020 programming period.

**Resuming payments in problematic OPs meant a higher risk population in 2012**

6.25. In 2012, the Commission resumed payments for several OPs which had previously been interrupted or suspended. Although systems may have been improved and financial corrections implemented after audits carried out by DG EMPL, some claims for which payments were interrupted may be reimbursed in full after resuming payments. This entails the risk that these claims still include projects with ineligible expenditure that had previously led to the imposed interruptions or suspension (see example (a) given in box 6.2).

## THE COMMISSION'S REPLIES

**6.23.** The Commission welcomes that the Court's audit work confirms the positive impact of simplified cost options in effectively reducing errors.

Besides reducing the administrative burden on beneficiaries, in particular smaller ones as it is often the case for ESF, one of the main reasons to implement simplified cost options is to further reduce the error rate in the Employment and Social Affairs policy area.

**6.24.** The Commission welcomes the Court's observation and support for the use of simplified cost options. The Commission considers it an encouragement for implementing its ambitious simplification action plan, which includes conducting simplification seminars in the large majority of Member States by the end of 2013.

**6.25.** The Commission's strict policy on interruptions and suspensions of payments mitigates the risk to the Community budget by stopping payments as soon as significant deficiencies are identified, often through its own audit work. Before resuming interim payments, the Commission requires the effective implementation of the necessary financial corrections and of the agreed action plan in order to prevent those deficiencies from reoccurring in the future. The Commission will follow up on the specific case identified by the Court in order to implement any additional financial corrections required.

<sup>(13)</sup> As amended by Article 1 of Regulation (EC) No 396/2009.

<sup>(14)</sup> EC Guidance Note COCOF 09/0025/04-EN on Indirect costs declared on a flat rate basis, flat rate costs calculated by application of standard scales of unit costs and lump sums, final version of 28 January 2010.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Errors found in closed OPs**

6.26. The Court's sample included 16 transactions with final payments for the closure of two 2000-2006 OPs. The Court identified quantifiable errors in five transactions for a programme that was closed without any financial correction <sup>(15)</sup>.

6.27. This corroborates the conclusions of the closures system's audit included in last year's annual report <sup>(16)</sup> that unreliable closure documentation may lead to irregular expenditure being finally reimbursed unless the Commission takes the necessary corrective action during subsequent stages.

**6.26.** As shown in the overview report on financial corrections implemented on the 2000-2006 programming period submitted to the European Parliament on 23 April 2013, DG EMPL has taken a prudent approach to closure, as reflected by the fact that at the date of the overview report, the closure process was still on-going for 61 ESF programmes and 5 closure audits were still planned for 2013. The overview report shows that, taking into account the financial corrections already implemented and the additional ones resulting from the closure of the remaining 61 ESF programmes, a total of 2,4 billion euro of financial corrections is estimated to be implemented for the ESF programmes. Taking the above into account, the Commission takes note of the 5 specific errors identified by the Court in one closed OP and will implement the necessary additional corrections.

**6.27.** The Commission agrees that the 2000-2006 closure is a complex process and involves certain risks arising from the sometimes not fully reliable closure documentation provided by the Member States for certain specific OPs. Therefore, DG EMPL has put in place the necessary measures to mitigate those risks, including significant financial corrections and 5 closure audits planned in 2013 (see also reply to paragraph 6.27). It should also be noted that, even after closure, the Commission can still implement financial corrections if new facts, such as those identified by the Court, arise. While acknowledging the above risks, the Commission emphasizes that the 2000-2006 closure process is still underway.

**EFFECTIVENESS OF SYSTEMS****The Court's examination of audit authorities**

6.28. **Annex 5.2** contains a summary of the results of the Court's examination of supervisory and control systems for four ERDF, CF and ESF AAs.

**6.28.** The Commission notes that the Audit Authorities play a central role in the assurance building process, as from the beginning of the programming period and set-up of systems. Thereafter, they report each year an audit opinion on the functioning of management and control systems to the Commission, based on audits on management and control systems and on samples of operations carried out as a general rule in accordance with an audit strategy. For this reason the Commission is closely cooperating and coordinating with them, and started reviewing their methodologies and audit results as early as 2009. This has contributed to capacity building by providing advice, guidance and recommendations to Audit Authorities. The regulation provides the Commission with the possibility to rely on the work of an audit authority for its assurance under certain conditions (Article 73).

<sup>(15)</sup> Spain (Comunidad Valenciana).

<sup>(16)</sup> See the 2011 annual report, paragraphs 5.52 to 5.64.



## THE COURT'S OBSERVATIONS

6.29. The Court assessed the work of two AAs in two Member States (the English AA in the United Kingdom and the Slovakian AA) as part of its examination of a total of four AAs covering the ERDF, CF and ESF. For the two AAs audited, the review of their work and re-performance of their audits of operations focused on ESF expenditure.

6.30. While the Slovakian AA is rated as effective, the English AA in the UK is rated as partially effective in complying with key regulatory requirements and in ensuring the regularity of transactions. The scope and specific results of the Court's audit of the AAs for all three funds (ERDF, CF and ESF) are reported in chapter 5 (paragraphs 5.46 to 5.49).

### Assessment of the Commission's supervision of AAs

6.31. The results of the Court's review of the Commission's supervision of AAs are shown in chapter 5 (see paragraphs 5.50 to 5.52).

6.32. The Commission calculates the error rates per OP based on the ACRs provided by the AAs. DG EMPL adjusted or considered unreliable the error rate reported for 31 of 117 ACRs in 2012 (42 of 117 ACRs in 2011).

6.33. In all cases where the Commission identified specific weaknesses as a result of its enquiries in Member States, the national authorities were notified concerning the corrective action to be taken. The Court identified some inconsistencies in the Commission's analysis of the ACRs. Some AAs shortcomings in calculating the error rate were not detected or corrected by the Commission. Nevertheless, these problems do not put into question the number and impact of the reservations formulated by DG EMPL in 2012.

### Review of DG EMPL annual activity report

6.34. The Court assessed the 2012 AAR and accompanying declaration of the Director-General of DG Employment, Social Affairs and Inclusion. In particular, with regard to the regularity of payments authorised in 2012, the Court:

- (a) assessed the reservations made in the AAR;
- (b) checked the consistency and accuracy of the Commission's calculation of the 'amounts at risk'.

## THE COMMISSION'S REPLIES

**6.29 and 6.30.** DG EMPL carried out audits to review the work of 84 ESF Audit Authorities at the end of 2012, including the Audit Authorities of the UK and Slovakia. The Commission's own assessment on these Audit Authorities is positive.

**6.32.** Before the Commission validates the rates reported by the AAs, it uses all audit procedures in place when doubts arise as to the accuracy and/or reliability of reported error rates: written and oral questions to AAs, fact-finding missions and/or analysis of additional information from the AAs, including individual audit results, if necessary. Based on this information, the error rates reported in the ACRs were adjusted in 18 (15,4 %) of the ESF OPs. Furthermore, the reported error rates for 13 (11,1 %) of the ESF OPs were considered as unreliable and therefore replaced by flat rates by the Commission.

**6.33.** The Commission considers that it has a thorough supervisory process in place in order to ensure the overall reliability of the ACRs for its own assurance process and to support the determination and quantification of the reservations made in its Annual Activity Report (see reply to paragraph 6.40(a)).

## THE COURT'S OBSERVATIONS

6.35. DG EMPL estimates that the overall error rate for the 2012 interim payments in the 2007-2013 programming period is in the range of 2,3 % to 3,2 %. Around 30 % of the payments were affected by material error (more than or equal to the 2 % materiality threshold set by the Commission).

6.36. The annual activity report of DG EMPL contains a reservation relating to the payments made for the 2007-2013 programming period for an amount of 68 million euro covering 27 of 117 OPs and a reservation, without financial impact, for 12 OPs of the 2000-2006 programming period.

6.37. In 2011, DG EMPL used the calculation of the cumulative financial risk for the 2007-2013 programming period for OPs with validated error rates between 2 % and 5 % in order to decide whether an OP should be the subject of a reservation. In 2012, DG EMPL extended this approach to the 20 OPs with validated error above 5 %. Although the cumulative financial risk calculated by the Commission was below 2 % for 13 OPs, eight of them were included in the reservation in the application of the principle of prudence. No reservation was introduced for the remaining five OPs. Only in one of these five cases the 2012 AAR disclosed the reasons for not issuing a reservation. The Court considers that the Commission should have disclosed this type of information also for the other four OPs concerned.

6.38. Chapter 1 contains information regarding the treatment of financial corrections (see paragraphs 1.19 to 1.37).

## THE COMMISSION'S REPLIES

**6.35.** The Commission considers that the fact that for 3 years in a row the Commission's own estimated error rate, as disclosed in DG EMPL's AAR, is in line with the Court's most likely error rate confirms the validity and reliability of its approach (see reply to paragraph 6.40(a)). Furthermore, these results show that the Commission has in place a sound process in order to supervise the information provided by the AA in their ACRs.

As mentioned in its 2012 AAR (page 37) the Commission underlines that out of its 2012 interim payments only 19,7 % were made to OPs with an error rate reported in the 2012 Annual Control Reports, submitted in December 2012, between 2 and 5 % and only 9,8 % to OPs with a reported error rate higher than 5 %. This clearly reflects the strict interruptions and suspensions policy systematically implemented by DG EMPL as for the OPs with cumulative error rates (over the full period since 2007) above 2 %, the Commission has imposed a corresponding financial correction or has implemented interruptions until such correction was done.

**6.37.** According to the Commission's standing instructions for the 2012 Annual Activity Report, a (quantified) reservation is required only if the cumulative financial risk is above 2 %, which was not the case in any of the 5 OPs mentioned by the Court, since the necessary financial corrections had already been implemented by the time the Annual Activity Report was issued. Furthermore, appropriate action plans were in place in order to prevent these issues from re-occurring in the 5 OPs concerned. The Commission takes note of the Court's observation in order to provide fuller disclosure in this respect in future Annual Activity Reports.

**6.38.** The Commission has taken all the necessary measures under the Treaty and foreseen in the regulations to protect the EU budget. The Commission notes that, whilst it has done everything within its power and acted in full respect of the existing regulations within the same financial year audited by the Court, the 25 % flat-rate correction applied to Romania has not been taken into account when determining the 2012 error rate. See replies to paragraph 6.39(a) and to Box 1.2.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**CONCLUSION AND RECOMMENDATIONS****The conclusion for 2012**

6.39. For the 'Employment and social affairs' policy area,

(a) testing of transactions indicates that the most likely error present in the population is 3,2 %, and

(b) the examined supervisory and control systems are partially effective in ensuring the regularity of operations for the 2007-2013 programming period.

6.40. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

**Recommendations**

6.41. **Annex 6.2** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented 10 recommendations for cohesion, transport and energy. Out of these recommendations, one was not applicable under the current framework. The Commission fully implemented one recommendation, while five were implemented in most respects, one was only implemented in some respects and one was not implemented at all. In one case it was not possible to obtain sufficient evidence of the actions taken.

**6.39.**

(a) *The Commission has in place a thorough process in order to support the assurance given in the AAR. The Commission considers that the fact that for 3 years in a row the Commission's own estimated error rate disclosed in DG EMPL's AAR is in line with the Court's most likely error rate confirms the validity and reliability of its approach. For 2012, DG EMPL's estimated error rate in its own AAR was within a range of 2,3 to 3,2 %. The Commission notes that the errors in one single OP in Romania represent a substantial part of the most likely error established by the Court. The Commission emphasizes that, it has implemented in December 2012 a 25 % flat rate correction on all expenditure certified by the Romanian authorities under this OP. The Commission notes that, whilst it has done everything within its power and acted in full respect of the existing regulations in order to protect the EU budget within the same financial year audited by the Court, the above flat rate correction has not been taken into account when determining the 2012 error rate. See reply to Box 1.2.*

(b) *The Commission considers that it has a thorough supervisory process in place in order to ensure the overall reliability of the work of the Audit Authorities for its own assurance. Based on its assessment, the Commission underlines that the effectiveness and compliance of audit authorities with the requirements may vary. In accordance with article 73 of Regulation 1083/2006, the Commission is, as from June 2012, formally relying on the work of 9 audit authorities for ESF (for 10 Operational Programmes). The Commission will continue to review the work of audit authorities.*

**6.40.** *The Commission has taken specific actions in order to mitigate the risks identified, which include in particular preventive and corrective measures such as guidance, training, simplification and a strict policy on interruptions and suspensions of payments and financial corrections.*

**6.41.** *Based on its own assessment, the Commission considers that out of the 10 recommendations for 2009 and 2010, 2 should be considered as fully implemented and 5 as implemented in most respects. The Commission considers the remaining 3 recommendations 'not applicable'.*

## THE COURT'S OBSERVATIONS

6.42. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission:

- **Recommendation 1:** addresses weaknesses in 'first level checks' carried out by managing authorities and intermediate bodies, through specific guidance material and, where appropriate, through training measures;
- **Recommendation 2:** on the basis of its experience gained of the 2007-2013 programming period, carries out an assessment of the use of national eligibility rules in view of identifying possible areas for further simplification and eliminating unnecessary complex rules;

## THE COMMISSION'S REPLIES

**6.42.**

*The Commission agrees on the importance of the 'first level' checks conducted by the Member States and shares the view that these should be further strengthened. Therefore, it has given guidelines to Member States on the way Managing Authorities should define and implement their management verifications. Moreover, the Commission developed in 2009 comprehensive guidelines for the first level checks and a self-assessment tool for managing authorities. The Commission has disseminated to the Audit Authorities in 2011 checklists for the audit of management verifications, which can be used by the Managing Authorities as a benchmark. Beyond the above actions, being aware of the critical role of the management verifications, DG EMPL has sent in November 2012 a note to all Managing Authorities drawing their attention to the need to further strengthen the reliability and thoroughness of the management verifications and announcing a thematic audit on management verifications, to be conducted in 2013 on 7 selected OPs in 6 Member States. This thematic audit is currently underway. Once finalized, the Commission will prepare an overview report summarizing its results and lessons learned to be shared with all Member States.*

*The Commission fully shares the need to further simplify national eligibility rules and eliminate unnecessary complex rules, which have a detrimental impact in terms of the burden on beneficiaries and increased error rate. The Commission underlines that whilst a systematic assessment of all national eligibility rules is not feasible, any identified instances of 'gold plating' have been addressed jointly with the Member States concerned (see reply to paragraph 6.18). The Commission is committed to present a report to the Discharge Authority on gold plating in ESF Operational Programmes in October 2013. The Commission will also continue encouraging and supporting national authorities in their simplification efforts. A series of seminars have been organized by DG EMPL in 2011-2013 to support the managing authorities in this effort (see also the Commission's reply to recommendation 3)*

## THE COURT'S OBSERVATIONS

- **Recommendation 3:** promotes the extensive use of simplified cost options with a view to reducing the risk of error in cost declarations and the administrative burden on beneficiaries. The flat rates for simplified cost options should be systematically approved/validated in advance by the Commission to ensure that they meet the regulatory requirements (fair, equitable and verifiable calculation);
  
- **Recommendation 4:** seeks improvement in the work done by audit authorities and the quality and reliability of the information provided in ACRs and audit opinions.

## THE COMMISSION'S REPLIES

*The Commission agrees with the Court on the importance of effectively implementing simplified cost options across all Member States. This is precisely why, besides introducing SCOs in the current regulatory framework, the Commission has very actively promoted their effective implementation in the 2007-2013 programming period, including simplification seminars conducted to date involving 17 Member States. The fact that currently 60 % of the ESF OPs already use at least one of these options shows a reasonable success in this regard. For the 2014-2020 programming period, SCOs are further strengthened, including, among others, the possibility to use flat rates already enshrined in the regulations.*

*The Commission agrees with the importance of this issue. The work of the Audit Authorities as reflected in the ACRs is one of the main elements on which the Commission builds its assurance. Further guidance on the treatment of errors has been provided to the Audit Authorities in 2011 and numerous seminars have been organised by the Commission in 2012 in order to further improve the audit sampling methodology used in preparation of the ACRs.*

## ANNEX 6.1

## RESULTS OF TRANSACTION TESTING FOR EMPLOYMENT AND SOCIAL AFFAIRS

	2012				2011	2010	2009
	ESF + IPA		Other social matters				
SIZE AND STRUCTURE OF THE SAMPLE							
Total transactions:	168		12		180	66	44
RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>							
Proportion (number) of transactions tested found to be:							
Free of error	65 %	(109)	67 %	(8)	65 %	73 %	75 %
Affected by one or more errors	35 %	(59)	33 %	(4)	35 %	27 %	25 %
Analysis of transactions affected by error							
Analysis by type of error							
Non-Quantifiable errors:	54 %	(32)	0 %	(0)	51 %	39 %	0 %
Quantifiable errors:	46 %	(27)	100 %	(4)	49 %	61 %	100 %
Eligibility	89 %	(24)	100 %	(4)	90 %	91 %	64 %
Occurrence	7 %	(2)	0 %	(0)	7 %	9 %	0 %
Accuracy	4 %	(1)	0 %	(0)	3 %	0 %	36 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS							
Most likely error rate					3,2 %		
Upper error limit (UEL)					5,1 %		
Lower error limit (LEL)					1,3 %		

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## FOLLOW UP OF PREVIOUS RECOMMENDATIONS FOR COHESION, TRANSPORT AND ENERGY

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	N/A under the current framework	Insufficient evidence	
			In most respects	In some respects				
2010	<b>Recommendation 1:</b> continue to monitor compliance with the eligibility requirements for EU funding, including in particular the correct application of EU and national public procurement rules;		X					
	<b>Recommendation 2:</b> encourage national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission. Whenever significant deficiencies in the functioning of the management and control systems are identified by national or EU bodies, the Commission should continue to interrupt or suspend payments to the OP until corrective action has been taken by the Member State;		X <sup>(1)</sup>					
	<b>Recommendation 3:</b> on the basis of its experience gained during the first years of the 2007-2013 programming period, carry out an assessment of the use of national eligibility rules in view of identifying possible areas for further simplification and to eliminate potential sources of errors for the period after 2013;				X			A systemic assessment of all national eligibility rules is not feasible. The Commission considers that the most effective way forward is through the active promotion of simplified cost options.
	<b>Recommendation 4:</b> propose an amendment to the structural funds regulations for the current programming period, in order to require Member States to report on the financial implementation of FEIs. The implementation of the funds should also be checked by the Commission on a regular basis;	X						
	<b>Recommendation 5:</b> provide further guidance to AAs for the current programming period, in particular on sampling, the scope of verifications to be undertaken for audits of projects and the reporting of audit findings;		X <sup>(2)</sup>					

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	N/A under the current framework	Insufficient evidence	
			In most respects	In some respects				
2010	<b>Recommendation 6:</b> propose to align the reporting periods of the annual control reports with the financial year of the EU budget in the Structural Funds regulations for the period after 2013 and to harmonise the approaches, so that the AAs’ audit opinions can be aggregated for each Fund at the national and EU levels.					X		<i>The Commission reflected this recommendation in its proposals for 2014-2020.</i>
2009	<b>Recommendation 1:</b> encourage national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission;		X <sup>(3)</sup>					
	<b>Recommendation 2:</b> ensure that the substitution of ineligible with new expenditure (withdrawal) does not result in new irregular expenditure being declared by Member States;						X	
	<b>Recommendation 3:</b> ensure, through its supervision, an effective functioning of the national management and control systems for the 2007-2013 programming period.			X				<i>The Commission strictly implements its supervisory role through, where appropriate, interruptions and suspensions of payments, and financial corrections.</i>
	<b>Recommendation 4:</b> to monitor closely the correct application of the EU Directives on public procurement in Member States.		X					

<sup>(1)</sup> From the Commission's side, the recommendation could be assessed as fully implemented, but there's still room for improvement at Member State level.

<sup>(2)</sup> The recommendation is implemented with regard to provision of guidance for sampling and for the scope of verifications. However, regarding the reporting of audit findings progress is required.

<sup>(3)</sup> See recommendation 2 for the 2010 annual report.



## CHAPTER 7

**External relations, aid and enlargement**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

7.1. This chapter presents the specific assessment of external relations, aid and enlargement, which comprises policy areas: 'External relations', 'Development and relations with African, Caribbean and Pacific (APC) States' <sup>(1)</sup>, 'Humanitarian aid' and 'Enlargement'. Key information on the activities covered and the spending in 2012 is provided in **Table 7.1**.

**Table 7.1 — External relations, aid and enlargement — key information 2012**

(million euro)

Policy area	Description	Payments	Management mode
External relations	European Neighbourhood Policy and relations with Russia	1 420	Centralised direct/decentralised
	Relations with Asia, Central Asia and Middle Eastern countries	595	Centralised direct/decentralised/joint
	Relations with Latin America	292	Centralised direct/decentralised
	Crisis response and global threats to security	278	Centralised direct/joint
	Common foreign and security policy	265	Centralised direct/indirect/joint
	Administrative expenditure	157	Centralised direct
	European Instrument for Democracy and Human Rights (EIDHR)	140	Centralised direct
	Cooperation with third countries in the area of migration and asylum	43	Centralised direct
	Policy strategy and coordination	24	Centralised direct
	Relation and cooperation with industrialised third countries	19	Centralised direct
		<b>3 233</b>	
Development and relations with ACP states	Administrative expenditure	340	Centralised direct
	Geographical cooperation with African, Caribbean and Pacific (ACP) States	288	Centralised direct/decentralised/joint
	Non-State actors in development	224	Centralised direct
	Food security	218	Centralised direct
	Human and social development	157	Centralised direct/joint
	Environment and sustainable management of natural resources, including energy	155	Centralised direct
	Development cooperation actions and ad hoc programmes	31	Centralised direct
	Policy strategy and coordination	16	Centralised direct
		<b>1 429</b>	

<sup>(1)</sup> Aid provided through the European Development Funds is reported separately as it is not financed from the general budget.

(million euro)

Policy area	Description	Payments	Management mode
Humanitarian aid	Humanitarian aid	1 073	Centralised direct/joint
	Administrative expenditure	35	Centralised direct
	Civil Protection Financial Instrument	20	Centralised direct
		<b>1 128</b>	
Enlargement	Enlargement process and strategy	851	Centralised direct/indirect/decentralised/joint
	Administrative expenditure	92	Centralised direct
		<b>943</b>	
Total payments for the year		<b>6 733</b>	
– total administrative expenditure <sup>(1)</sup>		624	
Total operational expenditure		<b>6 109</b>	
– advances <sup>(2)</sup>		4 009	
+ clearings of advances <sup>(2)</sup>		4 516	
<b>Audited population, total</b>		<b>6 616</b>	
<b>Total commitments for the year</b>		<b>9 021</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 9.

<sup>(2)</sup> In line with the harmonised definition of underlying transactions (for details see chapter 1, paragraphs 1.6 and 1.7).

Source: 2012 consolidated accounts of the European Union.

## THE COURT'S OBSERVATIONS

### Specific characteristics of the policy group

7.2. The EU's external activities cover four broad policy areas: 'External relations', 'Development aid', 'Enlargement' and 'Humanitarian aid'. In the fields of **external relations and development aid**, the European Union seeks to defend European interests, to promote European values, and to contribute to peace, security and sustainable development. In pursuit of these objectives, the EU implements a European Neighbourhood Policy, promotes human rights, champions free and fair trade and supports the social and economic development of its partners. Development aid is directed at achieving the Millennium Development Goals (MDGs), reducing poverty and integrating developing countries in the world economy. The objective of **enlargement** is to assist candidate and potential candidate countries to build up their capacity to exercise the rights and comply with the obligations that membership of the EU would involve. **Humanitarian aid** is intended to assist countries, regions and populations affected by natural or man-made disasters.

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THE COURT'S OBSERVATIONS

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7.3. Expenditure takes place through the following programmes and instruments:

- (a) geographical programmes, covering neighbourhood, enlargement and developing countries (3 477 million euro);
- (b) thematic programmes dealing with food security, non-state actors and local authorities, the environment, health and education, democracy and human rights (977 million euro);
- (c) foreign policy action under the Common Foreign and Security Policy, the Instrument for Stability, Election Observation Missions and the Industrialised Countries Instrument (562 million euro); and,
- (d) humanitarian aid and the European Civil Protection Mechanism (1 093 million euro).

7.4. Spending is managed by the Directorate-General for Development and Cooperation — EuropeAid, the Directorate-General for Enlargement — DG ELARG, the Directorate-General for Humanitarian Aid and Civil Protection — DG ECHO and the Service for Foreign Policy Instruments — FPI.

*Risks to regularity*

7.5. The expenditure covered in this chapter is made under a wide range of cooperation instruments and delivery methods, put into action in more than 150 countries. Rules and procedures are often complex, including those for tendering and the award of contracts. The Court has assessed risk as inherently high.

7.6. In two areas — budget support<sup>(2)</sup> and EU contributions to multi-donor projects carried out by international organisations<sup>(3)</sup> such as the UN — the nature of the instruments and payment conditions limit the extent to which transactions are prone to errors as defined in the Court's audit of regularity.

7.7. Budget support is paid in support of a state's general budget or its budget for a specific policy or objective. The Court examines whether the Commission has complied with the specific conditions for making budget support payments to the partner country concerned and has demonstrated that general eligibility conditions (such as progress in public sector financial management) have been complied with.

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<sup>(2)</sup> Budget support payments made from the general budget in 2012 amounted to 796 million euro.

<sup>(3)</sup> The payments made to international organisations from the general budget in 2012 amounted to 1,4 billion euro, more than half of which was implemented through multi-donor projects

## THE COURT'S OBSERVATIONS

7.8. However, the Commission has considerable flexibility in deciding whether these general conditions have been met. The Court's audit of regularity cannot go beyond the stage at which aid is paid to the partner country. The funds transferred are then merged with the recipient country's budget resources. Any weaknesses in its financial management will not generate errors in the Court's audit of regularity.

7.9. The Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of expenditure.

### Audit scope and approach

7.10. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of external relations, aid and enlargement, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 174 transactions as set out in **Annex 1.1**, paragraph 6. This sample was designed to be representative of the entire range of transactions within the policy group. In 2012, the sample consisted of 56 transactions approved by Commission headquarters and 118 approved by EU delegations <sup>(4)</sup>;
- (b) the assessment of systems covered the supervisory and control systems at EuropeAid and DG ELARG's headquarters and included the following aspects:
  - (i) ex ante checks and internal control standards;
  - (ii) monitoring and supervision; and
  - (iii) internal audits.

Where errors were detected, the relevant control systems were analysed to identify the specific weaknesses involved;

- (c) the Court reviewed the annual activity reports of DG ELARG and EuropeAid; and
- (d) it examined whether the Commission had followed the recommendations made in its 2009 and 2010 annual reports (see **Annex 7.3**).

<sup>(4)</sup> In Bangladesh, Bosnia and Herzegovina, Guatemala, Indonesia, Kosovo, Morocco, Palestine, Turkey, Ukraine, and Zambia.

## THE COURT'S OBSERVATIONS

7.11. EuropeAid, which manages 60 % of the expenditure in this policy group, also manages almost all expenditure from the European Development Fund (EDF). The Court's 2012 report on the EDF sets out the full results of the Court's examination of EuropeAid's supervisory and control systems and annual activity report, including in respect of expenditure from the general budget for which it is responsible. A summary of those results is set out in box 7.2.

## REGULARITY OF TRANSACTIONS

7.12. **Annex 7.1** contains a summary of the results of transaction testing. Out of the 174 transactions audited by the Court, 40 (23 %) were affected by errors. On the basis of the errors which it had quantified, the Court estimates the most likely error to be 3,3 % <sup>(5)</sup>.

7.13. The estimated error rate for the policy group is higher than the error rate estimated for 2011 (1,1 %). This difference should be interpreted in the light of the development of the Court's sampling approach (see chapter 1, paragraphs 1.6, 1.7 and 1.15).

7.14. In previous years the Court's sample of transactions included advances paid to beneficiaries. For 2012 however the Court's sample includes only interim payments, final payments and the clearance of advances. All of these involve a decision by the Commission that activities have been undertaken or expenditure has been incurred and that payment from the EU budget is justified; and allow the Court to form a realistic view of whether transactions have been regular.

7.15. Clearing of advances — a new element in the sample for 2012 representing 68 % by value of the audited population — contributed 3,2 percentage points of the total estimated error rate for the specific assessment.

7.16. The types of quantifiable errors found were as follows (see box 7.1):

- (a) 17 transactions were affected by eligibility errors, where payments had been made in respect of expenditure that was incurred outside the implementation period (three transactions), activities that were not covered by the contract (five transactions) or activities that were otherwise ineligible (nine transactions);

## THE COMMISSION'S REPLIES

**7.12.** *The Commission notes that the frequency of errors in 2012 has decreased as compared to the previous two exercises (41 % in 2011 and 38 % in 2010).*

**7.13.** *The Commission is pleased to note that the increase in the estimated error rate is not attributable to a deterioration in the control system, but to the development of the sampling approach.*

<sup>(5)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,4 % and 5,2 % (the lower and upper error limits respectively).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- (b) 10 transactions were affected by occurrence errors relating to the absence of invoices or other supporting documents for the expenditure; and,
- (c) three transactions were affected by accuracy errors.

**Box 7.1 — Examples of quantifiable errors****Ineligible expenditure**

The Commission made payments of 90 000 euro to a non-governmental organisation in Guatemala. It reimbursed VAT, which was ineligible, and salaries for staff who worked outside the period covered by the grant. Around 18 % of the expenditure reimbursed was not eligible.

**Absence of supporting evidence**

The Commission paid 16,7 million euro, towards a programme to support female teachers in rural secondary schools in Bangladesh. For 8,6 million euro, no documentation was available to the Commission when it approved the expenditure, nor to the Court when it audited it. In addition, the Commission accepted as a cost 0,5 million euro which had not been used and for which it did not launch a recovery order.

In 2012, the Commission approved the expenditure of 29 million euro implemented by an international organisation during the period 2003-2005 without sufficient documentary evidence. The latter could not be obtained by the auditors as the period for which the beneficiary organisation was required to keep documents and accounting information had already ended.

***A common feature of the two latter errors is the Commission's long delay in carrying out the final validation of expenditure.***

7.17. All of these errors occurred in transactions which had in principle been subject to the Commission's checks; none had been prevented or detected. In 12 transactions, the Court found errors that had not been detected by the auditors appointed by the beneficiaries.

7.18. A further 10 out of the 174 transactions were affected by non-quantifiable errors mainly relating to non-compliance with legal or contractual obligations.

7.19. Of 35 procurement procedures checked by the Court, six were found to be affected by error. In two of them, the contract was awarded to a tenderer who was either not eligible or had not submitted the best offer.

7.17. *The Commission attaches the greatest importance to the quality of audits and is developing tools to help audit managers in the Commission better assess the quality of audit reports.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**EFFECTIVENESS OF SYSTEMS**

7.20. **Annex 7.2** contains a summary of the results of the Court's examination of supervisory and control systems.

**DG Enlargement**

7.21. In its 2009 and 2010 annual reports, the Court made a number of recommendations concerning the supervisory and control systems at DG ELARG. The Commission has put all these recommendations into effect (see **Annex 7.3**). The Court did not identify further weaknesses during the 2012 audit.

7.22. Overall, DG ELARG's supervisory and control system is therefore considered effective.

7.23. For 2012, the Director-General of DG ELARG declared that he had obtained assurance regarding the reliability of the figures published in the annual activity report (AAR). However, DG ELARG does not have a residual error rate for its overall policy area. Its calculation of the residual error rate (below the 2 % materiality level) is based solely on payments made via decentralised management, which only represented 26 % of the payments in the year. The calculation did not take into account payments made via centralised management.

**EuropeAid**

7.24. A summary of the Court's findings about effectiveness of EuropeAid's supervisory and control systems is presented in box 7.2.

**Box 7.2 — EuropeAid: Summary of the Court's Findings about effectiveness of systems <sup>(6)</sup>***Ex ante checks*

The frequency of errors found, including in final claims of expenditure which had in principle been subject to external audits and expenditure verifications, points to weaknesses in checks before payment.

Late clearing and contract closure affect the quality of ex ante checks and significantly increase the risk of a broken audit trail or lack of supporting documents. In both EDF and general budget transactions, the Court found old contracts, for which expenditure was cleared late.

7.23. A 'Manual of Procedures for ex post controls in centralised management and for the calculation of a residual error rate' was approved by the Director General on 20 December 2012. Several audit missions have already been carried out. The RER measurement in centralised management will form an important part of the information at Director-General disposal when signing the Declaration of Assurance in the Annual Activity Report.

**Box 7.2 — EuropeAid: Summary of the Court's Findings about effectiveness of systems***Ex-ante checks*

The Commission agrees that while the design of EuropeAid's control system is broadly consistent and sound, progress still has to be made on the implementation of the control mechanisms.

Moreover, the Commission highlights the fact that the frequency of errors for external aid as a whole has decreased as compared to previous years.

<sup>(6)</sup> The detailed results of the assessment of EuropeAid systems, including EuropeAid's annual activity report, are presented in the Court's annual report on the 8th, 9th and 10th European Development Funds, paragraphs 31 to 44.



## THE COURT'S OBSERVATIONS

## Monitoring and supervision

Shortcomings persist in EuropeAid's management information system on the results and the follow-up of external audits, expenditure verifications and monitoring visits.

There are weaknesses in the selection, planning and follow-up of monitoring visits made by the EU delegations.

## 2012 Residual Error Rate study

EuropeAid carried out its first study to assess the level of errors which have evaded all management checks to prevent, detect and correct errors: the Residual Error Rate (RER) study. The study estimates the RER at 3,63 %.

The design of the RER methodology was in general appropriate and the study has provided interesting and potentially useful information. However, there is scope for further refinement in the methodology relating to the degree of reliance placed upon previous audit or verification reports, to the method of calculation of error rates on individual transactions, and to the treatment of transactions where there was no readily obtainable documentation.

## Internal audit

The Commission's 2011 reorganisation continues adversely to affect the activity of the Internal Audit Capability (IAC).

## THE COMMISSION'S REPLIES

As part of an external study in 2012 EuropeAid has put in place a procedure that reviews all contracts for which the activity period has expired for more than 18 months. The services are requested to comment on the reason for the contracts still being open and their plan to ensure the contracts can be closed as soon as possible. This has led to a decrease in open contracts at year end as compared to 2011. A similar exercise has been launched in April 2013 so as to continue this effort.

## Monitoring and supervision

The audit module of the external aid management information system (CRIS) was designed to plan, and record the results of external audits rather than track audit follow-up made by EuropeAid. However, EuropeAid planned to develop this functionality in the medium term, resources permitting.

EuropeAid developed a work plan tool for planning of missions. Additionally, EuropeAid is setting up a reform on monitoring and reporting to be implemented in early 2014.

## 2012 Residual Error Rate study

The results of the 2012 RER study fed directly into the 2012 AAR assurance process and therefore were actually very useful to EuropeAid. The 2012 RER study was the first one implemented and the lessons learnt from this first exercise will allow for refinements in the methodology.

EuropeAid will discuss the issues of the degree of reliance on previous audit or verification reports as well as the method of calculation of error rates with the contractor.

The steps to be undertaken to perform estimations are set out in detail in the revised RER instruction manual which will be applied for the 2013 RER exercise.

## Internal Audit

Since 2013, due to several measures taken in this respect, the functioning of the IAC has been improving.

## THE COURT'S OBSERVATIONS

## Annual activity report (AAR)

The Director-General makes a reservation concerning the legality and regularity of transactions since the amount considered at risk (259,5 million euro) represents more than 2 % of payments authorised in the reporting period.

The presentation of the RER study's results in the AAR is misleading:

- the RER is not a 'maximum amount' but a best estimate (or most likely estimate). The true level of error could be higher;
- the RER is not an estimate of the amount 'at risk' but an estimate of the error which remains undetected and uncorrected at the end of the management cycle and thus is definitive <sup>(7)</sup>;
- supervisory and control systems are not effective when they fail to detect and correct material error;
- the AAR describes the main types of errors occurring in EuropeAid expenditure but, with the exception of weaknesses in the recovery process, it does not analyse why they occurred and which aspects of EuropeAid's supervisory and control system failed.

## THE COMMISSION'S REPLIES

## Annual Activity Report (AAR)

*As foreseen in EuropeAid's procedures, an Action Plan has been set up in order to further improve the internal control system. It includes, inter alia, awareness raising actions, training and guidance, reinforcement of the accountability of Delegations, an increased cooperation with international organisations and streamlining the control system.*

- *The Commission agrees that the amount at risk mentioned in EuropeAid's 2012 AAR is the most likely estimate, in accordance with the Standing Instructions for the Annual Activity Reports for 2012. The true level of error could be higher, but also lower.*
- *The concept of 'amount at risk' is applied in the AAR in full compliance with the Commission's standing instructions for the preparation of the AAR. These instructions define the 'amount at risk' as the financial impact of the errors in terms of actual budgetary financial exposure during the calendar year.*

*The Commission agrees that the results of the RER study are not an estimate of the amount at risk.*

- *Most errors are linked to a limited number of weaknesses concerning mainly the implementation of controls. The design of the control system therefore appears to be sound and does not need to be modified.*
- *EuropeAid will undertake for the next Annual Activity Report the analysis requested in the standing instructions. The above mentioned Action Plan addresses all types of errors identified by the control system and the Court of Auditors. The Action Plan was preceded by a thorough analysis of the origins of these errors. In addition, it also included definitions of the ways in which errors — outlined in the Action Plan — are tackled. The analysis concluded that the control design as such was sound and that the errors which occurred were due to implementation issues.*

<sup>(7)</sup> 'Residual errors are those that have evaded all prevention, detection and correction controls in the existing control framework'. (A Manual for Measuring the Residual Error Rate for EuropeAid, May 2013).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**CONCLUSIONS AND RECOMMENDATIONS****The conclusion for 2012**

7.25. For this policy group:

- (a) testing of transactions indicates that the most likely error present in the population is 3,3 %; and
- (b) the supervisory and control systems examined at EuropeAid were partially effective; and
- (c) the supervisory and control systems examined at DG ELARG were effective.

7.26. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

**Recommendations**

7.27. *Annex 7.3* shows the result of the Court's review of progress in addressing recommendations made in the previous annual reports. In the 2009 and 2010 annual reports, the Court presented eleven recommendations. The Commission fully implemented seven of them, while four were implemented in most respects.

7.28. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission should:

- **Recommendation 1:** ensure timely clearance of expenditure;
- **Recommendation 2:** promote better document management by implementing partners and beneficiaries;
- **Recommendation 3:** improve the management of contract awarding procedures by setting out clear selection criteria and documenting the evaluation process better;

7.25.

- (a) *The Commission notes that the increase in the error estimated by the Court is linked to the changes in the sampling approach of the Court.*
- (b) *The Commission agrees that, while the design of EuropeAid's control system is broadly consistent and sound, progress has still to be made on the implementation of the control mechanisms.*

7.28.

*The Commission accepts this recommendation and action has recently been taken with a view to ensuring clearance of expenditure is done without delay.*

*The Commission agrees with the recommendation.*

*The Commission accepts this recommendation, and the Action Plan approved in May 2013 includes measures concerning the revision of existing training on procurement and grants in order to reinforce financial and operational aspects linked to procurement procedures.*

## THE COURT'S OBSERVATIONS

- **Recommendation 4:** take effective steps in order to enhance the quality of expenditure checks carried out by external auditors;
- **Recommendation 5:** apply a consistent and robust methodology for the external relations directorates-general to calculate residual error rates.

## THE COMMISSION'S REPLIES

*The Commission accepts this recommendation and in the framework of the Action Plan it has planned to examine in 2013 the possibilities of enhancing the quality and effectiveness of audits and verifications. This will be carried out notably with regard to audits and verifications conducted by local audit firms hired by the beneficiaries.*

*The standing instructions on the AARs contain harmonised guidelines which can be used throughout the Commission on reporting in the AAR for the calculation of (residual) error rates, the financial impact of these errors as amount at risk, the materiality for a potential reservation and their impact on the AOD's declaration of assurance.*

## ANNEX 7.1

## RESULTS OF TRANSACTION TESTING FOR EXTERNAL RELATIONS, AID AND ENLARGEMENT

	2012					2011	2010	2009
	EuropeAid <sup>(3)</sup>	FPI	ELARG	ECHO	Total			
SIZE AND STRUCTURE OF THE SAMPLE								
Total transactions:	109	7	34	24	174	120	90	97
RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>								
Proportion of transactions tested found to be:								
Free of error	65 % (71)	100 % (7)	97 % (33)	96 % (23)	77 % (134)	59 %	62 %	80 %
Affected by one or more errors	35 % (38)	0 % —	3 % (1)	4 % (1)	23 % (40)	41 %	38 %	20 %
Analysis of transactions affected by error								
Analysis by type of error								
Non-Quantifiable errors:	24 % (9)	0 % —	100 % (1)	0 % —	25 % (10)	55 %	47 %	74 %
Quantifiable errors:	76 % (29)	0 % —	0 % —	100 % (1)	75 % (30)	45 %	53 %	26 %
Eligibility	59 % (17)	0 % —	0 % —	0 % —	57 % (17)	86 %	72 %	100 %
Occurrence	34 % (10)	0 % —	0 % —	0 % —	33 % (10)	0 %	17 %	0 %
Accuracy	7 % (2)	0 % —	0 % —	100 % (1)	10 % (3)	14 %	11 %	0 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS								
Most likely error rate					3,3 %			
Upper Error Limit (UEL)					5,2 %			
Lower Error Limit (LEL)					1,4 %			

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

<sup>(3)</sup> Includes four transactions from the Education, Audiovisual and Culture Executive Agency.

RESULTS OF EXAMINATION OF SYSTEMS FOR EXTERNAL RELATIONS, AID AND ENLARGEMENT

	<i>Ex-ante</i> controls	Monitoring and supervision	Internal audit	Overall assessment
EuropeAid	Partially effective	Partially effective	Partially effective	Partially effective
DG Enlargement	Effective	Effective	Effective	Effective

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR EXTERNAL RELATIONS, AID AND ENLARGEMENT

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	DG ELARG should set out in greater detail the criteria for lifting ex ante control and suspending the 'conferral of management' to decentralised countries and test the performance of the systems used by national authorities.  (This is the 2010 follow up/update of a 2009 recommendation)	X						DG ELARG considers that the CRIS audit module is appropriate for management needs, and that the information requested by the Court and needed for management can be made available via the current CRIS tool.   

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	The Commission should establish a coherent methodology for the external relations directorate to calculate the residual error rate based on which directors-general deliver their management representations.	X						
2009	DG RELEX should devote sufficient resources to the analysis and closure of the old RRM and the CFSP contracts for which the implementation deadlines have already expired.		X					
	DG RELEX should consolidate its ex post control methodology and promptly address the recommendations made by the internal auditor in this respect.	X						
	DG ELARG should continue to devote sufficient resources to the analysis of the outstanding final declarations submitted under PHARE and the Transition Facility in the new Member States.	X						
	DG ECHO should design and introduce a mechanism for collecting and analysing the data concerning the use of 'Humanitarian Procurement Centres' by its partners.		X					DG ECHO has assessed and tested different options to effectively collect the data. The selected solution will be fully implemented in 2014 with the introduction of the new 'e-single form' as part of the new framework partnership with DG ECHO partners. Partners will be required to provide data on the use of the Humanitarian Procurement Centres through the 'e-single form' tool. The output of this measure will allow monitoring the use of the HPCs in a more regular and effective way.



## CHAPTER 8

**Research and other internal policies**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

8.1. This chapter presents the specific assessment of research and other internal policies, which comprises policy areas 'Research', 'Education and culture', 'Information society and media', 'Enterprise', 'Home affairs', 'Economic and financial affairs', 'Direct research', 'Communication', 'Justice', 'Trade', 'Internal market' and 'Competition'. This chapter also presents the Court's recurrent audit of the Guarantee Fund for External Actions <sup>(1)</sup>. Key information on the activities covered and the spending in 2012 is provided in **Table 8.1**.

Table 8.1 — Research and other internal policies — key information 2012

(million euro)

Policy area	Description	Payments	Management mode
Research	FP7	4 230	Centralised direct
	Completion of previous framework programmes (FPs)	376	Centralised direct
	Administrative expenditure	348	Centralised direct
	FP7 Euratom	353	Centralised indirect
		<b>5 307</b>	
Education and culture	Lifelong learning, including multilingualism	1 529	Centralised indirect
	People — programme for the mobility of researchers	751	Centralised indirect
	Encouraging and promoting cooperation in the field of youth and sports	177	Centralised indirect
	Developing cultural cooperation in Europe	173	Centralised indirect
	Administrative expenditure	131	Centralised direct
		<b>2 761</b>	
Information society and media	FP7	1 217	Centralised direct
	Other	155	Centralised direct
	Administrative expenditure	129	Centralised direct
		<b>1 501</b>	

<sup>(1)</sup> Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 establishing a Guarantee Fund for external actions (OJ L 145, 10.6.2009, p. 10) stipulates in its recitals that the financial management of the Guarantee Fund should be subject to audit by the Court of Auditors in accordance with the procedures agreed upon by the Court of Auditors, the Commission and the European Investment Bank.

(million euro)

Policy area	Description	Payments	Management mode
Enterprise	FP7 — Cooperation — space and security	572	Centralised direct
	EU satellite navigation programmes (EGNOS and Galileo)	416	Centralised direct
	Administrative expenditure	126	Centralised direct
	Competitiveness, industrial policy, innovation and entrepreneurship	126	Centralised direct/centralised indirect via EACI
	Internal market for goods and sectorial policies	31	Centralised direct
		<b>1 271</b>	
Home Affairs	Solidarity — External borders, visa policy and free movement of people	453	Shared /Centralised direct
	Security and safeguarding liberties	167	Centralised direct
	Migration flows — Common immigration and asylum policies	170	Shared/Centralised direct
	Administrative expenditure	42	Centralised direct
	Policy strategy and coordination	3	Centralised direct
		<b>835</b>	
Economic and financial affairs	Financial operations and instruments	370	Centralised direct/joint management with EIF/centralised indirect via EIF
	Administrative expenditure	71	Centralised direct
	International economic and financial affairs	30	Centralised direct
	Economic and monetary union	13	Centralised direct
		<b>484</b>	
Direct research	Staff, running costs and investments	371	Centralised direct
	FP7	42	Centralised direct
	Historical liabilities resulting from nuclear activities	28	Centralised direct
	Completion of previous framework programmes (FPs)	25	Centralised direct
		<b>466</b>	
Communication	Administrative expenditure	128	Centralised direct
	Communication and the media	39	Centralised direct
	Going Local communication	33	Centralised direct
	Fostering European Citizenship	32	Centralised direct
	Analysis and communication tools	24	Centralised direct
		<b>256</b>	

(million euro)

Policy area	Description	Payments	Management mode
Justice	Justice in criminal and civil matters	68	Centralised direct
	Fundamental rights and citizenship	47	Centralised direct
	Administrative expenditure	35	Centralised direct
	Equality	34	Centralised direct
	Drugs prevention and information	3	Centralised direct
	Policy strategy and coordination	3	Centralised direct
		<b>190</b>	
Trade	Administrative expenditure	94	Centralised direct
	Trade policy	11	Centralised direct / joint management with IO
		<b>105</b>	
Internal market	Administrative expenditure	60	Centralised direct
	Policy strategy and coordination for the Directorate-General for the Internal Market	39	Centralised direct
		<b>99</b>	
Competition	Administrative expenditure	92	Centralised direct
	Cartels, anti-trust and liberalisation	—	Centralised direct
		<b>92</b>	

Total payments for the year	<b>13 367</b>
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– total administrative expenditure <sup>(1)</sup>	1 627
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Total operational expenditure	<b>11 740</b>
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– advances <sup>(2)</sup>	7 712
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+ clearings of advances <sup>(2)</sup>	6 639
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<b>Audited population, total</b>	<b>10 667</b>
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<b>Total commitments for the year</b>	<b>16 365</b>
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<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 9.

<sup>(2)</sup> In line with the harmonised definition of underlying transactions (for details see chapter 1, paragraphs 1.6 to 1.7).

Source: 2012 consolidated accounts of the European Union.

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group***Policy objectives*

8.2. The spending covers a wide range of policy objectives, such as support to research and innovation, development of education and training, protection of the EU external borders, judicial cooperation, completion of the internal market, and implementation of rules on competition.

*Policy instruments*

8.3. The main funding instruments in this policy group are the Research Framework Programmes (FPs) amounting to 7 957 million euro or 68 % of the operational expenditure and the Lifelong Learning Programme (LLP) amounting to 1 529 million euro or 13 % of the operational expenditure.

8.4. The FPs are implemented under centralised direct and centralised indirect management involving seven Commission directorates-general and two executive agencies <sup>(2)</sup>. Part of the budget is also implemented under centralised indirect management by bodies such as the EU research joint undertakings <sup>(3)</sup> the European Investment Bank and international public sector organisations <sup>(4)</sup>.

8.5. Most of the funds are spent on grants to beneficiaries undertaking research projects in the Member States and in associated and accession countries and international cooperation partner countries. Beneficiaries usually work as a consortium of partners on the basis of a grant agreement with the Commission. One project partner coordinates the project, receiving funding from the Commission and distributing the amounts due to the other partners.

<sup>(2)</sup> The seven directorates-general are: DG Research and Innovation (RTD), DG Communications Networks, Content and Technology (CNECT), DG Joint Research Centre (JRC), DG Education and Culture (EAC), DG Enterprise and Industry (ENTR), DG Mobility and Transport (MOVE) and DG Energy (ENER). The two executive agencies are: the Research Executive Agency (REA) and the European Research Council Executive Agency (ERCEA).

<sup>(3)</sup> The European Union research joint undertakings (JUs) are: the European JU for ITER and the Development of Fusion Energy; the Clean Sky JU; the Artemis JU; the Innovative Medicines Initiative JU; the ENIAC JU; and the Fuel Cells and Hydrogen JU.

<sup>(4)</sup> For example, the European Space Agency (ESA), the European Association of National Metrology Institutes (EURAMET) and the European and Developing Countries Clinical Trials Partnership (EDCTP).

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THE COURT'S OBSERVATIONS

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8.6. The Commission introduced simplification measures in 2011, such as the wider acceptance of beneficiaries' methodologies for calculating average personnel costs. While such measures have contributed to reducing the administrative burden for beneficiaries, the underlying eligibility rules for the current FPs remain complex. The Commission has proposed more far-reaching simplification measures for the next FP ('Horizon 2020').

8.7. The LLP aims to enable people to take part in learning experiences, and to develop the education and training sector across Europe. The LLP has four main sub-programmes: Erasmus for higher education, Leonardo da Vinci for vocational education and training, Grundtvig for adult education and Comenius for schools.

8.8. Around 85 % of LLP spending is implemented through centralised indirect management by 40 national agencies (NAs) which conclude grant agreements with the Commission. The NAs are designated and supervised by national authorities (NAUs), usually ministries of education. The NAs are responsible for the evaluation, selection and management of projects, including payment of the numerous but relatively small grants to participating organisations.

#### *Risks to regularity*

8.9. The principal risk of irregularity is that beneficiaries include ineligible or unsubstantiated costs in their cost statements, which are neither detected nor corrected by the supervisory and control systems. The risk is exacerbated by the complexity of the rules for calculating eligible costs and the requirement for beneficiaries to allocate personnel and indirect costs to projects, while deducting various items considered ineligible for EU co-financing.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Audit scope and approach**

8.10. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of research and other internal policies, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 150 transactions as defined in **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of transactions within the policy group. Out of the 150 transactions, 90 related to research FPs interim or final payments and clearings and 60 to other internal policies payments and clearings. For 30 interim payments to research projects (25 of the sampled FP7 transactions plus a supplementary sample of five other FP7 projects), this examination also covered the Commission's evaluation of project proposals;
- (b) the assessment of systems examined:
  - (i) the research FPs and the LLP;
  - (ii) the 2012 annual activity reports (AARs) of DG RTD, DG EAC, DG ECFIN <sup>(5)</sup> and REA.

8.11. The audit of the Guarantee Fund focused on compliance with the agreement between the Commission and the EIB for the management of the Fund's assets as well as the Commission's monitoring procedures. The work performed by a private firm of auditors was also reviewed.

**REGULARITY OF TRANSACTIONS**

8.12. **Annex 8.1** contains a summary of the results of transaction testing. Out of the 150 transactions audited by the Court 73 (49 %) were affected by error. On the basis of the errors which it had quantified, the Court estimates the most likely error to be 3,9 % <sup>(6)</sup>.

**8.12.** *The Commission refers to its reply to paragraph 1.11 in which it explains the implications of a multiannual framework for the implementation of operational programmes. As a consequence of the operation of its internal control system in the policy area covered by this chapter, the Commission has implemented recoveries of 120 million euro in 2012.*

<sup>(5)</sup> Directorate-General for Economic and Financial Affairs.

<sup>(6)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,8 % and 6,0 % (the lower and upper error limits respectively).

## THE COURT'S OBSERVATIONS

8.13. The estimated error rate for this policy group is higher than that estimated for 2011. This difference should be interpreted in the light of the development of the Court's sampling approach (see paragraphs 1.6, 1.7 and 1.15).

8.14. In previous years, the Court's sample of transactions for this policy group included advances paid to beneficiaries. For 2012, however, the Court's sample includes only interim payments, final payments and the clearance of advances <sup>(7)</sup>. All of these involve a decision by the Commission that activities have been undertaken or expenditure has been incurred and that payment from the EU budget is justified; and allow the Court to form a more realistic view of whether transactions have been regular.

8.15. Clearing of advances — a new element in the sample for 2012 representing 62 % by value of the audited population — contributed 2,1 percentage points of the overall estimated error rate for the specific assessment. In previous years, the Court examined advances for this policy group at the point they were paid out, i.e. upon the signature of the grant agreement or adoption of the financing decision, before the final recipients of the funds undertake activities or incur costs (see also **Annex 1.1**, paragraph 6). Quantifiable errors are more frequently identified when advances are cleared than when they are paid out.

8.16. In total, the Court found that 73 (49 %) out of 150 tested transactions were affected by errors. The main sources of error remain the inclusion of ineligible costs in research FPs project cost statements and the use of incorrect methodologies by FP beneficiaries for the calculation of personnel and indirect costs (see box 8.1). Other reasons for error include lack of supporting documentation for declared costs, errors in time recording and non-compliance with rules on sub-contracting.

8.17. The type and frequency of errors in the declaration of expenditure by research beneficiaries are corroborated by the Commission's own ex post audits, where most errors are detected in the categories of personnel costs and indirect costs.

## THE COMMISSION'S REPLIES

**8.13.** *The Commission is pleased to note that the increase in the estimated error rate is not attributable to a deterioration in the control system, but to the development of the sampling approach.*

**8.16.** *The Commission shares the analysis of the Court as regards the main sources of error. For this reason the Commission has proposed simplified rules (e.g. a mandatory flat rate for indirect costs) under Horizon 2020 to reduce complexity for participants and, consequently, to reduce the error rate.*

<sup>(7)</sup> Under their common audit strategy for FPs, the research DGs examine only interim and final payments to beneficiaries, and advances are not included in the audit population.



## THE COURT'S OBSERVATIONS

**Box 8.1 — Errors in costs declared for an FP7 project**

A beneficiary involved in a FP7 project declared costs of 1,7 million euro in its cost statement, leading to reimbursement by the Commission of the EU contribution of some 1,2 million euro. The Court detected several errors in the declared costs, including:

- incorrectly calculated personnel costs, based on budgeted rather than actual figures;
- unsubstantiated travel costs and inclusion of ineligible indirect taxes (VAT) in the declared travel costs;
- declaration of an amount of indirect costs based on incorrectly calculated hourly overhead rates and including ineligible cost categories not linked to the project.

The ineligible costs declared by the beneficiary amounted to some 60 000 euro. As the EU co-financing rate for this project is 70 %, the Commission has unduly reimbursed 42 000 euro.

## THE COMMISSION'S REPLIES

**Box 8.1 — Errors in costs declared for an FP7 project**

*Indirect costs are a regular source of error, which is why the Commission proposed, for Horizon 2020, to avoid these errors by having a single flat rate for this type of cost.*

8.18. The Commission has significantly reduced the time it takes to make research grant payments. However, the Court found several cases in 2012 where project coordinators incurred lengthy delays in transferring the funds to other project partners. Such delays can have serious financial consequences, especially on small and medium-sized enterprises (SMEs) or other beneficiaries highly dependent on EU funding.

8.19. The Court's testing of the Commission's evaluation of 30 FP7 project proposals found that, in all cases audited, the Commission had carried out appropriate assessment of the proposals before signing grant agreements.

**8.18.** *The distribution of funds is a matter subject to the provisions of the consortium agreement concluded by the beneficiaries and, to which the Commission is not a party. Nevertheless, the Commission regularly reminds the coordinators about this obligation.*

## THE COURT'S OBSERVATIONS

8.20. Two of the largest quantifiable errors within other internal policies were detected in ICT-PSP<sup>(8)</sup> projects within the Competitiveness and Innovation Framework Programme (CIP) (see box 8.2). In its 2011 annual report, the Court also reported large errors in ICT-PSP transactions and identified weaknesses in CIP supervisory and control systems<sup>(9)</sup>

**Box 8.2 — Errors in costs declared for an ICT-PSP project**

A beneficiary involved in an ICT-PSP project declared more than 1 million euro in its cost statement, leading to reimbursement by the Commission of the EU contribution of some 500 000 euro. The Court detected several errors in the declared costs, including:

- costs claimed for in-house consultants, but with no evidence of the work actually carried out for the project;
- ineligible costs such as recoverable value added tax and expenditure not related to the project;
- ineligible sub-contracted costs and weaknesses in the related contract award procedures;
- ineligible indirect costs, as these costs were declared as a flat rate based on personnel costs.

The ineligible costs declared by the beneficiary amounted to some 940 000 euro. As the EU co-financing rate for this project is 50 %, the Commission has unduly reimbursed around 470 000 euro.

## THE COMMISSION'S REPLIES

**8.20.** *The dedicated audit strategy for non-research projects has been implemented throughout 2012-2013 aiming at 215 audits of non-research projects (ICT PSP included) by 2017. All of these audits will focus on beneficiaries which present a high risk profile.*

*In addition, it is to be noted that the Commission has introduced a single audit strategy specific to non-research funded projects (including ICT PSP). In 2012, 27 such ex post audits were launched and another 15 in 2013. More audits on non-research projects will be launched in the second half of 2013.*

**Box 8.2 — Errors in costs declared for an ICT-PSP project**

*The Commission will take the necessary measures to recover the unduly paid amounts pending the finalisation of the contradictory procedures with the audited beneficiaries.*

**EFFECTIVENESS OF SYSTEMS**

8.21. **Annex 8.2** contains a summary of the results of the Court's examination of supervisory and control systems. For the research FPs, the Court found that the systems were partially effective in ensuring the regularity of transactions. For LLP, the Court found that the systems were effective in ensuring the regularity of transactions.

<sup>(8)</sup> Information and Communication Technologies Policy Support Programme.

<sup>(9)</sup> See the 2011 annual report, paragraphs 8.31 to 8.34.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.22. The AARs reviewed by the Court provide a fair assessment of financial management in relation to the regularity of underlying transactions, and the information provided corroborates the Court's findings and conclusions in most respects. The AAR of DG Research and Innovation is an example of good practice, providing a clear and comprehensive analysis of the factors affecting the regularity of expenditure.

## Research Framework Programmes

### *Ex ante desk checks*

8.23. The Commission makes ex ante desk checks before authorising a payment or clearing. Scientific/Project officers verify that the work carried out by the beneficiary is in compliance with the grant agreement by evaluating the project reports and deliverables. Financial officers carry out accounting and arithmetical checks to ensure financial statements and audit certificates have been submitted in accordance with the provisions of the grant agreement. Additional 'in depth' ex ante desk checks may be carried out, based on supplementary information provided by the beneficiary, such as invoices or payslips.

8.24. The 90 audited research transactions revealed cases where the checks did not detect errors which were in the information submitted by the beneficiary. As an example, the Commission accepted for reimbursement subcontracting costs which had not been included in the grant agreement. In another case, the checks did not detect the incorrect classification of costs in the cost statement, leading to an incorrect rate of reimbursement. This control procedure is partially effective.

### *Audit certification of cost statements*

8.25. Research grant agreements set out the conditions under which beneficiaries' cost statements should include a certificate issued by an independent auditor. FP7 beneficiaries are required to provide an audit certificate if their EU contribution exceeds 375 000 euro. The independent auditor should certify that the costs declared are in line with the eligibility criteria set out in the grant agreement.

8.24. The Commission considers that its ex ante controls are implemented in a way that provides appropriate flexibility to ensure a good scientific outcome and to provide a good balance between trust and control. The Commission is committed to avoiding an overly formalistic application of the rules which would be seriously detrimental to achieving good scientific outcomes and would add excessive red tape to the framework programme.

Nevertheless, the Commission continues to review its ex ante checks. Improvement of ex ante checks without imposing additional administrative burdens on beneficiaries, and whilst ensuring that payments to researchers are paid promptly, is a permanent challenge.

## THE COURT'S OBSERVATIONS

8.26. For those cost statements audited by the Court for which a certificate had been provided (29 out of the 90 sampled transactions), the Court compared the results of its own audit with the conclusion of the independent auditor. In nine cases where the independent auditor had certified the cost statement, the Court found a significant level of error in the declared costs.

8.27. While certification of cost statements helps to reduce the level of error for the FPs as a whole, the Court continues to find a significant level of error in cost statements certified by the independent auditor. This control procedure is partially effective.

*The Commission's ex post financial audits*

8.28. The Commission's programme of ex post audits of beneficiaries is a key element of the supervisory and control systems for the research FPs. The ex post audits are carried out by Commission audit staff, and by external audit firms on behalf of the Commission. The results provide essential input to the Director-Generals' annual declarations of assurance concerning the regularity of transactions, and form the basis for the recovery of any unduly paid EU funds over the remaining years of the FP.

8.29. The Court reviewed the state of implementation of the research DGs' common ex post audit strategy for FP6 and FP7. In particular, the Court assessed progress in meeting the targets for the numbers of completed audits.

8.30. For FP6, there were 75 ongoing audits at the end of 2012, although the ex post audits of FP6 were initially planned to be concluded by the end of 2010. However, the programme of FP6 audits was extended, in order to increase the likelihood of detecting errors and reduce the residual error rate.

8.31. For FP7, the target set out in the common ex post audit strategy for the total number of audits closed up to the end of 2012 has largely been met by the Commission. However, for REA and ERCEA, the number of closed audits has fallen short of their individual targets.

## THE COMMISSION'S REPLIES

**8.27.** *The Commission is aware that the CFS does not entirely avoid errors, but nevertheless they reduce error levels substantially. They are therefore an important contributor to the overall level of assurance of the Commission.*

**8.31.** *The audit campaigns of the REA and ERCEA started a little later than had been assumed in the audit strategy. This has meant that their individual targets for closing audits have not been met at the end of 2012. However, the number of audits launched has met the targets, and REA and ERCEA are confident that the targets for closing audits will be met by the end of the framework programme.*

## THE COURT'S OBSERVATIONS

8.32. The audits may lead to the need to make adjustments to beneficiaries' cost statements, usually by the Commission offsetting ineligible amounts against the next payment to the project. At the end of 2012, 92 % of FP6 adjustments and 60 % of FP7 adjustments had been implemented. Taking into consideration that the majority of pending adjustments are linked to audits closed in 2012, these rates are satisfactory.

8.33. In cases where systematic errors are identified, the Commission applies extrapolated corrections. At the end of 2012, 78 % of FP6 and 37 % of FP7 cases of extrapolated corrections were implemented. Most of the FP7 cases were opened in 2012, so that the correction can only take place in 2013 or later. For FP6, 1 506 cases of extrapolated corrections out of a total of 7 101 cases still need to be implemented. Of these, 1 336 relate to audits closed in 2011 or earlier.

8.34. The deadlines imposed on the external audit firms for the completion of audits are frequently not met. The audits carried out by Commission audit staff are also subject to significant delays in completion. While such delays are often a result of factors beyond the Commission's control, closer monitoring could help to reduce these delays.

8.35. The Commission's ex post audit strategy for the research FPs is designed to provide assurance on a multiannual basis and contributes to reducing the residual error rate for the FPs. The strategy as such is a strong element of the Commission's supervisory and control systems. However, due to its multiannual nature, the strategy does not lead to a reduction in the error rate within the financial year.

## THE COMMISSION'S REPLIES

**8.34.** *The Commission has put in place additional measures to reduce the delays in the completion of audits.*

*However, beneficiaries regularly send additional information after the audit visit, or require additional time to undertake the contradictory procedure, thereby leading to delays in the completion of the audits. In addition some audits may require intensive consultation to ensure that consistent positions are taken in all cases, or may depend on legal advice.*

*The Commission took the decision to accept documents and other argumentation from beneficiaries even if it arrives late. This decision, which may affect the timely completion of audits, is to ensure appropriate rights of defence for the beneficiaries and to prioritise the best possible support for science.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Lifelong Learning Programme**

8.36. The Court audited the Commission's procedures for the closure of LLP agreements with NAs, based on a sample of 10 closures. The audit focused on whether the Commission had a sound basis for closure and covered the scope of checks made (including financial and non-financial aspects), the separation of duties, the calculation of the final eligible amount and the clearing of pre-financing recorded in the Commission's accounting system.

8.37. The Court considers that, in all cases audited, the Commission had carried out appropriate assessment and checks of the relevant files, and had a sound basis for closure of the agreements. The Court's transaction testing sample included three projects under LLP agreements closed in 2012. The Court found no significant errors in these transactions.

8.38. The control procedures within DG Education and Culture in relation to the closure of LLP agreements with NAs are considered to be effective.

**CONCLUSION AND RECOMMENDATIONS****The conclusion for 2012**

8.39. For this policy group,

- testing of transactions indicates that the most likely error present in the population is 3,9 % and
- the examined supervisory and control systems for research FPs are assessed as partially effective. The examined supervisory and control system for LLP is assessed as effective.

8.40. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

**8.39.** *The Commission refers to its reply to paragraph 1.11 in which it explains the implications of a multiannual framework for the implementation of operational programmes. As a consequence of the operation of its internal control system in the policy areas covered by this chapter, the Commission has implemented recoveries of 120 million euro in 2012.*

*The Commission considers that, seen from a management perspective — i.e., when balancing the objectives in terms of legality and regularity with considerations on risk-proportionality and cost-effectiveness of controls — its management and control systems provide reasonable assurance, subject to reservations issued by the Authorising Officers by delegation in their annual activity reports.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Recommendations**

8.41. **Annex 8.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented seven recommendations. Out of these recommendations, one was no longer applicable. The Commission fully implemented two recommendations, while four were implemented in most respects.

8.42. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission should:

- **Recommendation 1:** further intensify its efforts to address the errors found in interim and final payments and clearings, in particular by reminding beneficiaries and independent auditors of the eligibility rules and the requirement for beneficiaries to substantiate all declared costs;
- **Recommendation 2:** remind research FP project coordinators of their responsibility to distribute the funds received to the other project partners without undue delay;
- **Recommendation 3:** review the cases of weaknesses in ex ante checks identified by the Court in order to assess if the checks require modification;
- **Recommendation 4:** reduce delays in the implementation of ex post audits and increase the implementation rate for extrapolation cases;

**8.42.**

*The Commission has been running a communication campaign to remind beneficiaries and their auditors of the eligibility rules. 1 700 people attended 10 seminars in 2012, among them at least 235 auditors. One event in Germany was exclusively for auditors. 1 170 people have attended the 10 events so far held in 2013, of which around 180 were auditors. Three more events are planned for the remainder of 2013.*

*The Commission services will continue to write to certifying auditors where the Commission's ex post audits identify material differences between the certified cost statements and its own findings.*

*The Commission will also try to address the issue at the contracting stage, by ensuring that participants are made aware of the most common errors in cost claims.*

*The issue is also addressed by the proposal for Horizon 2020, which includes a number of simplifications that would reduce the inherent risk of error.*

*The distribution of funds is a matter subject to the provisions of the consortium agreement concluded by the beneficiaries, to which the Commission is not a party. Nevertheless, the Commission regularly reminds the coordinators about this obligation.*

*The Commission continues to review its ex ante checks. Improvement of ex ante checks without imposing additional administrative burdens on beneficiaries, and whilst ensuring that payments to researchers are paid promptly, is a permanent challenge.*

*The Commission will continue its efforts to reduce delays in audit completion and to complete the extrapolation of audit findings.*

## THE COURT'S OBSERVATIONS

- **Recommendation 5:** reinforce the supervisory and control systems for CIP ICT-PSP.

## THE COMMISSION'S REPLIES

*The dedicated audit strategy for non-research projects has been implemented throughout 2012-2013 aiming at 215 audits of non-research projects (ICT PSP included) by 2017. All of these audits will focus on beneficiaries which present a high risk profile.*

*In addition, it is to be noted that the Commission has introduced an audit strategy specific to non-research funded projects (including ICT PSP). In 2012, 27 such ex post audits were launched and another 15 in 2013. More audits on non-research projects will be launched in the second half of 2013. The Commission also applies the same ex ante controls to the CIP ICT PSP as to the other funding schemes.*

## RESULTS OF THE AUDIT OF THE GUARANTEE FUND FOR EXTERNAL ACTIONS

8.43. The purpose of the Guarantee Fund for External Actions, which guarantees EU loans to non-Member States, is to reimburse the EU's creditors in the event of a beneficiary's defaulting on a loan and to avoid direct calls on the EU budget. The administrative management of the Fund is carried out by DG ECFIN, while the European Investment Bank (EIB) is responsible for its treasury management.

8.44. At 31 December 2012, as shown in the 2012 consolidated accounts of the EU, the Fund's net assets were 1 845 million euro <sup>(10)</sup>, compared with 1 475 million euro at 31 December 2011. During the year, a guarantee call of 24 million euro was made.

8.45. The EIB and the Commission use a benchmark index to review the Fund's annual performance. The return on the Fund's portfolio in 2012 amounted to 7,796 %, representing a performance of 394 basis points above the benchmark.

<sup>(10)</sup> The total net assets of the Fund before consolidation were 1 865,5 million euro.



## ANNEX 8.1

## RESULTS OF TRANSACTION TESTING FOR RESEARCH AND OTHER INTERNAL POLICIES

	2012					2011	2010	2009
	FP6	FP7	LLP	Other	Total			
SIZE AND STRUCTURE OF THE SAMPLE								
Total transactions:	11	79	21	39	150	86	73	226
RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>								
Proportion of transactions tested found to be:								
Free of error	27 % (3)	39 % (31)	62 % (13)	77 % (30)	51 % (77)	51 %	61 %	72 %
Affected by one or more errors	73 % (8)	61 % (48)	38 % (8)	23 % (9)	49 % (73)	49 %	39 %	28 %
Analysis of transactions affected by error								
Analysis by type of error								
Non-Quantifiable errors:	25 % (2)	31 % (15)	37 % (3)	33 % (3)	32 % (23)	38 %	33 %	33 %
Quantifiable errors:	75 % (6)	69 % (33)	63 % (5)	67 % (6)	68 % (50)	62 %	67 %	61 %
Eligibility	100 % (6)	100 % (33)	100 % (5)	100 % (6)	100 % (50)	98 %	97 %	52 %
Occurrence	0 % (0)	0 % (0)	0 % (0)	0 % (0)	0 % (0)	0 %	6 %	7 %
Accuracy	0 % (0)	0 % (0)	0 % (0)	0 % (0)	0 % (0)	2 %	3 %	38 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS								
Most likely error rate					3,9 %			
Upper error limit					6,0 %			
Lower error limit					1,8 %			

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 8.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR RESEARCH AND OTHER INTERNAL POLICIES

## Assessment of the systems examined

System concerned	Ex ante desk checks	Audit certification	Ex post financial audits	Overall assessment
Research framework programmes (FPs)	Partially effective	Partially effective	N/A <sup>(1)</sup>	<b>Partially effective</b>

System concerned	Closure	Overall assessment
Lifelong Learning Programme (LLP)	Effective	<b>Effective</b>

<sup>(1)</sup> See paragraph 8.35.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR RESEARCH AND OTHER INTERNAL POLICIES

Year	Court Recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	No longer applicable		Insufficient evidence
			In most respects	In some respects				
2010	The Court recommends that the Commission should:							
	— in the area of the research FPs:							
	<b>Recommendation 1:</b>  (i) draw on the lessons learnt from the good practice of DG INFSO's risk-based ex post auditing method to further enhance the Commission's ex ante controls with the aim of identifying payments with a relatively high-risk profile, and  <b>Recommendation 2:</b>  (ii) with the aim to further increase the reliability of the audit certificates, intensify its actions to raise the independent auditors' awareness of the eligibility of expenditure rules, notably by actively informing the auditors about instances of failure to identify ineligible costs. (paragraph 6.51)  <b>Recommendation 3</b>  — in the area of the LLP, continue to give emphasis to the implementation of primary controls. In particular attention should be given to ensuring that national agencies check at least the minimum number of files required by the Commission and that all checks are properly documented. (paragraph 6.51)	X	X					

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2009	The Court encourages the Commission to continue its efforts to ensure rigorous application of effective control systems. In the context of the current legal framework, the Commission should:							
	<b>Recommendation 4:</b>  (a) ensure that the independent auditors who have incorrectly certified cost statements are made aware of the eligibility criteria for declared costs with the aim to improve the reliability of the audit certificates they issue;		X					
	<b>Recommendation 5:</b>  (b) review the operation of the system for the certification of beneficiaries' costing methodologies and encourage beneficiaries to submit their cost calculation methodology for ex-ante certification;					X		
	<b>Recommendation 6:</b>  (c) reduce the backlog in recovering undue amounts paid, imposing sanctions where necessary. (paragraphs 5.49 and 8.32)		X					
	<b>Recommendation 7:</b>  The Court recommends that the Commission continues to reinforce the checks on closures to ensure that errors are detected and corrected and prevent the reoccurrence of previously identified errors. (paragraph 7.20)	X						

## CHAPTER 9

**Administrative and other expenditure**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

9.1. This chapter presents the specific assessment of the administrative and other expenditure of the institutions and bodies of the European Union. Key information on the institutions and bodies covered, and the spending in 2012 is provided in **Table 9.1**.

**Table 9.1 — Administrative and other expenditure — Key information 2012**

(million euro)

Policy area	Description	Payments	Management mode
Administrative and other expenditure	Commission	6 456	Centralised direct
	European Parliament	1 623	Centralised direct
	European External Action Service	731	Centralised direct
	Council	524	Centralised direct
	Court of Justice	343	Centralised direct
	Court of Auditors	136	Centralised direct
	Economic and Social Committee	127	Centralised direct
	Committee of the Regions	96	Centralised direct
	European Ombudsman	9	Centralised direct
	European Data Protection Supervisor	7	Centralised direct
Total payments for the year		10 052	
– advances <sup>(1)</sup>		264	
+ clearings of advances <sup>(1)</sup>		197	
<b>Audited population, total</b>		<b>9 985</b>	
<b>Total commitments for the year</b>		<b>10 366</b>	

<sup>(1)</sup> In line with the harmonised definition of underlying transactions (for details see chapter 1, paragraphs 1.6 and 1.7).

Source: 2012 consolidated accounts of the European Union.

9.2. This chapter also covers expenditure considered in the general budget as operational although its purpose is in most cases the functioning of the Commission's administration rather than policy delivery.

9.3. The Court reports separately on the EU agencies and other bodies and on the European Schools <sup>(1)</sup>. The Court's mandate does not cover the financial audit of the European Central Bank.

<sup>(1)</sup> The Court's specific annual report on the European Schools is submitted to the Board of Governors of the European Schools, and is copied to the European Parliament, the Council and the Commission. The Court's specific annual reports on agencies and other bodies are published in the Official Journal.

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group**

9.4. Administrative and other expenditure comprises expenditure on human resources (salaries, allowances and pensions), which accounts for 60 % of total administrative and other expenditure, and expenditure on buildings, equipment, energy, communications, and information technology.

9.5. Overall, the Court considers this policy group as a low risk area. The main risks regarding administrative and other expenditure are non-compliance with the procedures for procurement, for the implementation of contracts, for recruitment and for the calculation of salaries and allowances.

**Audit scope and approach**

9.6. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall approach and methodology. For the audit of administrative and other expenditure, the following specific points should be noted:

- the audit involved an examination of a sample of 151 payment transactions as defined in **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of transactions performed by the institutions and bodies within the policy group. In 2012 the sample consisted of 91 payments of salaries, pensions and related allowances and 60 payments on contracts related to buildings and other expenditure,
- the assessment of systems examined the compliance of the supervisory and control systems <sup>(2)</sup> applied by each institution and body with the requirements of the Financial Regulation. In addition, the Court audited procedures for recruiting temporary and contract staff and procurement procedures in the European Parliament and in the Council,
- the annual activity reports of four of the Commission's directorates-general and offices <sup>(3)</sup> primarily responsible for administrative expenditure were reviewed.

<sup>(2)</sup> Ex ante and ex post controls, internal audit function, exception reporting and internal control standards.

<sup>(3)</sup> Directorate-General for Human Resources and Security, Office for the Administration and Payment of individual Entitlements, Office for Infrastructure and Logistics in Brussels and Directorate-General for Informatics.

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THE COURT'S OBSERVATIONS

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9.7. The Court of Auditors is audited by an external audit firm<sup>(4)</sup> which issued an audit report on the financial statements for the financial year from 1 January 2012 to 31 December 2012 and an assurance report concerning the regularity of the use of the Court's resources, and the control procedures in place from 1 January 2012 to 31 December 2012 (see paragraph 9.15).

## REGULARITY OF TRANSACTIONS

9.8. **Annex 9.1** contains a summary of the results of transaction testing. Out of the 151 transactions audited by the Court, one was affected by error. On the basis of the errors which it had quantified, the Court estimates the most likely error to be 0 %<sup>(5)</sup>.

## EFFECTIVENESS OF SYSTEMS

9.9. **Annex 9.2** contains a summary of the results of the Court's examination of supervisory and control systems.

## OBSERVATIONS ON SPECIFIC INSTITUTIONS AND BODIES

9.10. The specific observations that follow are presented by institution or body of the European Union and do not affect the overall assessments set out in paragraphs 9.8 and 9.9. Whilst they are not material to administrative expenditure as a whole, they are significant in the context of the individual institution or body concerned.

### Parliament

#### Recruitment of temporary and contract staff

9.11. The audit did not find errors or weaknesses in the examination of 15 recruitment procedures.

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<sup>(4)</sup> PricewaterhouseCoopers, Société à responsabilité limitée, Réviseur d'Entreprises.

<sup>(5)</sup> The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population is 0 %.



THE COURT'S OBSERVATIONS

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**Procurement**

9.12. The audit examined 18 procurement procedures. Overall, no serious errors or weaknesses were detected. However, due to administrative errors, weaknesses were noted regarding, in one case, the management and documentation of the procurement procedure and in another case, the application of an award criterion.

**European Council and Council****Recruitment of temporary and contract staff**

9.13. The audit did not find errors or weaknesses in the examination of 15 recruitment procedures.

**Procurement**

9.14. The audit examined 15 procurement procedures. Overall, no serious errors or weaknesses were detected. However, due to errors in the design of the procedure, a weakness was identified, in one case, in the performance of a negotiated procedure and, in another case, in the application of a selection criterion.

**Court of Auditors**

9.15. The external auditor's report <sup>(6)</sup> states that, in the auditors' opinion, 'the financial statements give a true and fair view of the financial position of the European Court of Auditors as of 31 December 2012, and of its financial performance and its cash flows for the year then ended'.

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REPLY OF THE EUROPEAN PARLIAMENT

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**9.12.** *Parliament has taken note of the Court's observations in these individual cases and appropriate instructions have been given for the treatment of future procedures. As to the issue of the award criteria, Parliament notes that the procedure concerned a low value contract where the tenderer offering the lowest price has been awarded the contract.*

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<sup>(6)</sup> See the external auditor's report on the financial statements referred to in paragraph 9.7.

## THE COURT'S OBSERVATIONS

**Other institutions and bodies**

9.16. The audit did not identify any significant weakness in respect of the topics audited for the Commission, the Court of Justice of the European Union, the European Economic and Social Committee, the Committee of the Regions, the European Ombudsman, the European Data Protection Supervisor and the European External Action Service (EEAS). However, the audit noted that some weaknesses persisted in the management of social allowances at the Commission and at the EEAS.

## REPLY OF THE COMMISSION

**9.16.** *The staff has the obligation to declare to the PMO any change in their family situation and any allowances received from other sources. In order to reduce the weaknesses related to the lack of proactiveness or forgetfulness of some staff members in doing so, the PMO has put into place reminders, controls and IT solutions where feasible such as:*

- *a-posteriori controls,*
- *automatic IT updates of amounts of allowances received from other sources: 90 % of the population is already covered, last countries to be covered by the end of 2014,*
- *checks in the framework of existing procedures (entry into/end of service),*
- *development of front office forecasted modules in SYSPER2 (to be completed by the end of 2013).*

## REPLY OF THE EEAS

**9.16.** *The European External Action Service would stress that:*

- *The PMO has successfully tested its APP module ('allowances received from other sources') on EEAS staff at headquarters and delegations.*
- *Since 2013 the PMO has, in principle, systematically included the staff at headquarters and delegations in its automatic updates.*
- *The exercise was launched several times for staff of Belgian nationality.*
- *The module was applied to the other nationalities in successive phases: in May 2013 for Ireland and in the following months for France, the Netherlands and Finland.*
- *It is planned to include Sweden, Austria, Romania and Hungary in 2014.*
- *In addition, the EEAS will send staff a message in September reminding them of their obligation to keep their declarations updated.*

THE COURT'S OBSERVATIONS

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**CONCLUSION AND RECOMMENDATIONS****The conclusion for 2012**

9.17. For this policy group,

- testing of transactions indicates that the most likely error present in the population is nil, and
- while the Court has observed some errors and weaknesses (paragraphs 9.11 to 9.16), the examined supervisory and control systems are likely to reduce the rate of error present in initial payment requests to an acceptable level. These systems are therefore assessed as effective.

Overall audit evidence indicates that accepted expenditure is not affected by a material level of error.

**Recommendations**

9.18. *Annex 9.3* shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented nine recommendations. Out of these, four were not reviewed this year following the Court's rotation basis approach. The institutions concerned fully implemented one recommendation, while two were implemented in most respects and two were implemented in some respects.

9.19. Following this review and the findings and conclusions for 2012, the Court recommends that the Parliament and the European Council and Council (see paragraphs 9.12 and 9.14) should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance.

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REPLY OF THE COMMISSION

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**9.18.** See reply to paragraph 9.16.

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REPLY OF THE COUNCIL

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**9.19.** *The Council and European Council have a solid centralised procurement framework in place that was recently adapted to the new Financial Regulation and Rules of application and will be reinforced with the design of new templates of contracts and invitations to tender as well as the development of specific training courses on how to define and apply selection and award criteria.*

ANNEX 9.1

RESULTS OF TRANSACTION TESTING FOR ADMINISTRATIVE AND OTHER EXPENDITURE

2012				2011	2010	2009
Expenses related to staff	Expenses related to buildings	Other expenses (energy, communications, information technology, etc.)	Total			

SIZE AND STRUCTURE OF THE SAMPLE

Total transactions:	91	17	43	151	56	58	57
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RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>

Proportion (number) of transactions tested found to be:

Free of error	100 %	(91)	100 %	(17)	98 %	(42)	99 %	(150)	93 %	93 %	93 %
Affected by one or more errors	0 %	(0)	0 %	(0)	2 %	(1)	1 %	(1)	7 %	7 %	7 %

ESTIMATED IMPACT OF QUANTIFIABLE ERRORS

Most likely error rate	0 %
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<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments. The results of testing reflect the proportionate share each segment has within the policy group.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 9.2

## RESULTS OF THE EXAMINATION OF SYSTEMS FOR ADMINISTRATIVE AND OTHER EXPENDITURE

## Assessment of the systems examined

System concerned	European Parliament	European Council and Council	Other Institutions and bodies	Overall assessment
Recruitment, salaries and pensions	Effective	Effective	Effective	Effective
Procurement	Effective	Effective	Effective	Effective

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR ADMINISTRATIVE AND OTHER EXPENDITURE

Year	Court Recommendation	Court's analysis of the progress made					Institution reply
		Fully implemented	Being implemented		Not imple- mented	Insufficient evidence	
			In most respects	In some respects			
2010	<b>Parliament</b> <i>Recruitment of temporary and contract staff</i> The Parliament should ensure that appropriate documentation is established to justify the recruitment decisions made.	The in-depth examination of a sample of recruitments of temporary and contract staff (see paragraph 9.11) did not lead to any observation.					
	<b>European Economic and Social Committee</b> <i>Recruitment of temporary and contract staff</i> The European Economic and Social Committee should ensure that eligibility criteria set out in vacancy notices are respected.			The Court noted that, as a result of this recommendation, the European Economic and Social Committee has implemented measures to consolidate and strengthen rules on recruitment. Under the approach for rotating the in-depth examination of internal control systems among the Institutions, audit work will be performed in the area of recruitment in future years.			
	<b>Parliament</b> <i>Procurement</i> The Parliament should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures.			The in-depth examination of a sample of procurement procedures (see paragraph 9.12) showed that errors persist in the design, coordination and performance of procurement procedures.			
	<b>Commission (*)</b> <i>Procurement</i> The Commission should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures.						

(\*) Under the approach for rotating the in-depth examination of internal control systems among the Institutions, the follow-up of these recommendations will be performed in future years.

Year	Court Recommendation	Court's analysis of the progress made					Institution reply
		Fully implemented	Being implemented		Not imple- mented	Insufficient evidence	
			In most respects	In some respects			
2010	<b>European Economic and Social Committee (*)</b> <i>Procurement</i> The European Economic and Social Committee should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures.						
	<b>Committee of the Regions (*)</b> <i>Procurement</i> The Committee of the Regions should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures.						
2009	<b>Parliament</b> <i>Payment of social allowances to staff members</i> Staff should be requested to deliver at appropriate intervals documents confirming their personal situation. In addition, the Parliament should implement a system for the timely monitoring and control of these documents.		As mentioned in Annex 9.3 of the 2011 annual report, the Parliament implemented measures to mitigate the risk. The Court's audit did not show any new weakness. However, the risk of making incorrect or undue payments remains since the system in place is based on declarations by staff members.				<i>The measures taken in 2012 improved even further the response rate for the annual procedure for the electronic verification and updating of staff members' personal data. Where necessary, staff members' declarations are accompanied by appropriate supporting documents.</i>
	<b>Commission — DG RELEX</b> <i>Payment of social allowances and benefits to staff members</i> Staff should be requested to deliver at appropriate intervals to the Commission's services documents proving their personal situation. In addition, DG RELEX should implement a system for the timely monitoring and control of these documents.			As mentioned in Annex 9.3 of the 2011 annual report, the European External Action Service implemented measures to mitigate the risk in cooperation with the Office for Administration and Payment of Individual Entitlements (PMO) of the Commission. The Court's audit however showed that weaknesses persist (see paragraph 9.16).			

(\*) Under the approach for rotating the in-depth examination of internal control systems among the Institutions, the follow-up of these recommendations will be performed in future years.

Year	Court Recommendation	Court's analysis of the progress made					Institution reply
		Fully implemented	Being implemented		Not implemented	Insufficient evidence	
			In most respects	In some respects			
2009	<b>European Data Protection Supervisor</b> <i>Payment of social allowances to staff members</i> Staff should be requested to deliver at appropriate intervals documents proving their personal situation. In this respect, the European Data Protection Supervisor should improve its system for the timely monitoring and control of these documents.		As mentioned in Annex 9.3 of the 2011 annual report, the European Data Protection Supervisor implemented measures to mitigate the risk in cooperation with the Office for Administration and Payment of Individual Entitlements (PMO) of the Commission. The Court's audit did not show any new weakness. However, the risk of making incorrect or undue payments remains since the system in place is based on declarations by staff members.				<i>The EDPS takes good note of the results of the Court's analysis and will continue to improve its system for timely monitoring and control.</i>



## CHAPTER 10

**Getting results from the EU budget**

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## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**INTRODUCTION**

10.1. This chapter focuses on performance. It is divided into three parts. The first part presents the Court's observations on the management-plans (MP) and annual activity reports (AAR) of some of the Commission's directors-general. The second part covers the Commission's second and third evaluation reports<sup>(1)</sup>. The third part highlights some of the main themes arising and the lessons that can be learned from the Court's 2012 special reports<sup>(2)</sup> on performance.

10.2. Performance is assessed on the basis of the sound financial management principles (economy, efficiency and effectiveness)<sup>(3)</sup>. Its measurement is key throughout the public intervention process, covering inputs (financial, human, material, organisational or regulatory means needed for the implementation of the programme), outputs (the deliverables of the programme), results (the immediate effects of the programme on direct addressees or recipients) and impacts (long-term changes in society that are attributable to the EU's action).

**10.1.** *Measuring and reporting on performance is receiving growing attention within the Commission. Reporting on performance is to be considered as an evolving practise. The Communication 'Synthesis of the Commission's management achievements in 2012' (COM(2013) 334 final of 5 June 2013) defines a number of initiatives to further strengthen performance management in the Commission. This progressive development of a performance culture will take several years to come to full effect, partly because new statistical and other tools need to be developed.*

<sup>(1)</sup> Article 318 of the Treaty on the Functioning of the European Union (TFEU) provides for a report from the Commission to the European Parliament and the Council on the evaluation of the Union's finances based on the results achieved.

<sup>(2)</sup> The Court's special reports cover the EU budget, as well as the European Development Funds. They are available at the Court's website (<http://eca.europa.eu>).

<sup>(3)</sup> Council Regulation (EC, Euratom) No 1605/2002 on the Financial regulation applicable to the general budget of the European Communities, Article 27; repealed by Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1), Article 30 (entry into force on 1 January 2013).

## THE COURT'S OBSERVATIONS

10.3. For many areas of the EU budget the legislative framework is complex and there is a lack of focus on performance. Despite the claimed focus on results, the proposals for the new CSF regulations and the common agricultural policy (CAP) regulations for the 2014-2020 programming period remain fundamentally input-based (expenditure oriented) and therefore oriented towards compliance rather than performance<sup>(4)</sup>. For example regarding rural development, a disparate and wide ranging set of objectives is laid down in the regulation which does not include expected results and impacts or relevant indicators<sup>(5)</sup>.

## THE COMMISSION'S REPLIES

**10.3.** *The new regulations for the CAP do ensure a more performance-oriented approach, also under the second pillar:*

- *the EAFRD draft regulation does not include quantified targets at EU level, but requires that each Rural Development Programme (RDP) should be constructed around the achievement of quantified targets, which are strictly related to the objectives laid down in the regulation. The indicators to be used to define these targets will be laid down in the implementing act;*
- *besides, key planned outputs will be subject to a performance framework as foreseen under the Common Provision Regulation.*

*As regards the proposed Regulations for the European Structural and Investment Funds, resultorientation has been included as essential feature. The demanding and innovative proposals include:*

- *a reinforced intervention logic that links objectives set by the Union with binding and precise objectives set by the Member States;*
- *for the first time intervention-specific ex ante conditionalities to improve the effectiveness of investments;*
- *decisively extended macroeconomic conditionalities,*
- *a renewed approach to evaluation, based on planning, the obligation to evaluate the impact of each part of the programme, and the use of new methods, and*
- *an obligatory performance framework including a performance reserve.*

<sup>(4)</sup> Opinions No 7/2011 on the proposal for a Regulation of the European Parliament and of the Council 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 covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006 (OJ C 47, 17.2.2012), paragraph 6, and No 1/2012 on certain proposals for regulations relating to the common agricultural policy for the period 2014-2020, paragraph 8 (<http://eca.europa.eu>).

<sup>(5)</sup> Opinion No 1/2012, paragraph 8.

## THE COURT'S OBSERVATIONS

10.4. For large parts of the EU budget, mainly the European Agricultural Fund for Rural Development (EAFRD) and the cohesion funds (CSF), the maximum level of expenditure under the multi-annual financial framework (MFF) <sup>(6)</sup> headings is broken down into yearly allocations per Member States. As the Court pointed out in the past, it is a challenge to obtain good qualitative results from schemes where funds are pre-allocated among Member States <sup>(7)</sup> and absorption of these funds is an implicit objective <sup>(8)</sup>.

## THE COMMISSION'S REPLIES

**10.4.** *The new RDPs will be constructed around the achievement of quantified targets (related to the objectives of the regulation). The budget distribution to the different measures will be in line with these targets, ensuring consistency between the targets to be achieved and the means programmed for them. Besides, a performance reserve will be kept by the Commission, and only released at a later stage in the programming period, when Management Authorities can show that the RDPs have not failed to achieve preset milestones. Thus the prior objective of reaching the targets is strongly promoted.*

*The budget allocation by Member State is necessary for the purpose of programming, and in particular for the ex-ante quantification of targets which could otherwise not be done. Envelopes should be proportionate to the needs to be addressed in the different Member States.*

<sup>(6)</sup> The current multi-annual financial framework (MFF 2007-2013) agreed by the European Council and endorsed by the European Parliament, determines the amounts of the annual ceilings on commitments appropriations by category of expenditure and of the annual ceiling on payment appropriations. These categories of expenditure are the six MFF headings (for example 'Competitiveness for growth and employment' (heading 1 A) or 'Cohesion for growth and employment' (heading 1 B)).

<sup>(7)</sup> Based on criteria established by the Council, the Commission makes a breakdown by Member States (national envelopes) for example for rural development (Commission decision 2009/545/EC of 7 July 2009 fixing the annual breakdown per Member State of the amount referred to in Article 69(2a) of Council Regulation (EC) No 1698/2005 concerning support to rural development and amending Commission Decision 2006/636/EC (OJ L 181, 14.7.2009, p. 49)) or for the Regional competitiveness and employment objective (Commission decision 2006/593/EC of 4 August 2006 fixing an indicative allocation by Member State of the commitment appropriations for the Regional competitiveness and employment objective for the period 2007-2013 (OJ L 243, 6.9.2006, p. 32)).

<sup>(8)</sup> Opinion No 7/2011, paragraph 4.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**PART 1 — THE AAR'S REPORTING ON POLICY ACHIEVEMENTS IS EVOLVING BUT IT IS STILL OF LIMITED USE****Introduction**

10.5. The various management modes <sup>(9)</sup> for implementing the EU budget, taken together with the differing roles of DGs, mean that the Commission plays a number of different roles and bears a range of responsibilities. These should be — amongst other things — considered by the Commission when setting performance objectives and defining indicators in their MPs and reporting on them in AARs.

10.6. The Court examined the reporting requirements and processes concerning MPs and AARs including the relevant guidance provided and it reviewed the MPs and AARs (part 1) of the Directorate-General for Competition (DG COMP), the Directorate-General for Mobility and Transport (DG MOVE) and the Directorate-General for Maritime Affairs and Fisheries (DG MARE) for the year 2012. In particular, the Court assessed if the AARs provide useful information on the DGs' annual contribution to policy achievements <sup>(10)</sup>. The review was based on requirements established in the Financial Regulation, the Commission's internal control standards and the MP/AAR-instructions issued by the Commission's Secretariat-General (SG) and the Directorate-General for Budget (DG BUDG).

**10.5.** Commission services have been requested to define in their management plans objectives setting out the expected impacts and results. These objectives usually address societal problems that are being pursued through various means, including financial intervention, regulatory actions or law enforcement.

Consideration is being given to ways of improving transparency by better describing in the management plans the responsibilities the Commission fulfils in relation to its operational activities.

<sup>(9)</sup> In the Financial Regulation applicable in 2012 there were five management modes (centralised direct, centralised indirect, shared (MS), decentralised (third countries), and joint). In the Financial Regulation applicable since 1 January 2013 there are three main management modes (direct, indirect and shared).

<sup>(10)</sup> In chapter 8 of its 2010 annual report, the Court examined the AARs of DG for Agriculture and Rural Development (DG AGRI), DG for Regional and Urban Policy (DG REGIO) and DG for Research and Innovation (DG RTD). In chapter 10 of its 2011 annual report, it examined the AAR of EuropeAid and, again, those of DG AGRI and DG REGIO. The observations this year are similar to those of the 2010 and 2011 annual reports.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## Reporting on policy achievements needs improvement

10.7. The Financial Regulation requires that the Commission attach activity statements to the draft budget <sup>(11)</sup> presented to the budgetary authority. These activity statements should include SMART <sup>(12)</sup> objectives (at least one objective for each activity) for the various activities. These objectives should be measured by indicators. The objectives and indicators are to a large extent directly used by the directors-general as objectives in their MPs.

10.8. The directors-general should then report in part 1 of their AARs on the results achieved and on the extent to which the results have had the impact intended. In the Commission as a whole there are some 1 000 objectives and 3 000 indicators in the MPs taken together <sup>(13)</sup>.

10.9. The Court's review of the MPs and AARs of DG COMP, DG MOVE and DG MARE identified the following main issues affecting the reporting on annual policy achievements:

- (a) objectives taken directly from high level policy or legislative documents are often not sufficiently focused to be useful for MPs and AARs;
- (b) only eight of 52 objectives fulfilled all of the SMART criteria;
- (c) indicators for monitoring performance need improvement;
- (d) evaluations have not been a useful source of evidence to substantiate reporting on policy achievements in AARs.

**10.9.** *The Commission considers that it has made significant progress in recent years as regards reporting on policy achievements and that notably the Annual Activity Reports of its Directorates-General contain a wealth of useful information on the results attained and their impact on society.*

**(a)** *See Commission reply to paragraph 10.10.*

**(b)** *See Commission reply to paragraph 10.12.*

**(d)** *Different evaluations have been a useful source of information to support the policy achievements reported upon in Annual Activity Reports. However, not all evaluations directly serve the purpose of the Annual Activity Report as for instance they cover a different time-frame than the year which is reported in the Annual Activity Report.*

<sup>(11)</sup> Financial Regulation, Article 38(3)(e).

<sup>(12)</sup> A SMART objective fulfils the following criteria: specific, measurable, achievable, relevant and timed.

<sup>(13)</sup> The Commission has proposed the introduction of 'programme statements' to reduce the number of objectives and indicators (starting from the budgetary procedure for the financial year 2014).

THE COURT’S OBSERVATIONS

**Objectives directly taken from high level policy or legislative documents are often not sufficiently focused to be useful for AARs and MPs**

10.10. According to the 2012 Commission’s standing instructions for management plans, DGs should establish general objectives with impact indicators (long-term) and specific objectives with result indicators (short/medium-term). The objectives used in the MPs and AARs are often taken directly from legal texts, or high level policy documents. The three DGs examined referred to the binding nature of these texts as the underlying reason for this approach. While objectives in such documents should in particular provide the basis when setting general objectives, they are construed in a political context and are often not sufficiently focused to be useful for the purpose at the DG level (see for example box 10.1). In addition, the link between general and specific objectives was not clearly established (DG COMP and DG MARE). A similar conclusion has been made recently by the IAS which reported that for some AARs there is incomplete information on the link between general and specific objectives defined in the management plan.

**Box 10.1 — DG COMP — Policy goal not sufficiently focused at DG level**

DG COMP defines the general objective ‘To support growth, jobs and competitiveness’ and monitors its achievement by reference to the rate of real GDP growth, the employment rate of the population aged 20 to 64 and the percentage of EU GDP invested in research and development.

By using a high-level political objective and Commission overarching targets as impact indicators, DG COMP cannot demonstrate the extent of its own contribution to achieving policy goals.

THE COMMISSION’S REPLIES

**10.10.** The standing instructions for management plans require that the general objectives be aligned with the Commission’s political objectives by further elaborating them in the management plans. The rationale for this approach is given by the need to ensure that the Commission services follow up on the delivery of the political objectives and of the main policy priorities of the Commission. Objectives should focus mostly on impacts and results, even though these are normally only partly attributable to the actions of the services.

*Being instrumental to ensuring Commission’s public accountability, objectives focus mostly on impacts and results, even in the case these are normally only partly attributable to the actions of the services and are influenced by other external factors.*

The Commission will consider amendments to the standing instructions for the management plans in order to improve the presentation of the linkages between the general and specific objectives. See also Commission reply to Box 10.1.

**Box 10.1 — DG COMP — Policy goal not sufficiently focused at DG level**

The Commission acknowledges the inherent methodological difficulty in demonstrating via competition specific quantitative impact indicators, instead of employing more general indicators, such as GDP growth, the contribution that competition policy makes towards achieving Europe 2020 Strategy. The link between this general objective and the Commission’s enforcement actions and policy initiatives is explained in pages 4 to 5 of the 2012 AAR.

DG COMP identifies general objective ‘to support growth, jobs and competitiveness’ in order to properly embed the DG’s policies within those of the European Commission in accordance with internal guidance of the Commission.

THE COURT’S OBSERVATIONS

10.11. The MPs do not clearly set out how the planned activities at each management level will contribute to the achievement of objectives set, taking into account the allocated resources and the risks identified. This has a negative impact on the usefulness of the reporting on policy achievements in part 1 of the AAR. As such the objectives might be relevant to the policy area within which the DGs operate but are not sufficiently focused to allow for the monitoring of their achievement over time (for example, with milestones).

Only eight of 52 objectives fulfilled all the SMART criteria

10.12. DGs’ objectives should be clearly defined and updated when necessary. They should be formulated in a way that makes it possible to monitor their achievement. That is to say objectives should be SMART. However, only eight out of the 52 examined objectives fulfilled all the SMART criteria (for one example see box 10.2). While the objectives examined were relevant to the policy area in which the DGs operated they were often not sufficiently specific, measurable or timed to follow-up.

**Box 10.2 — Objectives DG MOVE**

A SMART objective

To ‘implement the core transport network by 2030’ is one objective of DG MOVE. This objective is specific, timed and relevant. The measurability of this objective is provided in quantified terms in the MP and AAR (for example as ‘five removed bottlenecks on the core transport routes by 2017’).

Objective not SMART

One of the specific objectives presented by DG MOVE in its MP 2012 is: ‘To promote a modern urban mobility’. This objective is not SMART. It is neither specific as it does not provide any information on what needs to be changed nor is it measurable or timed.

THE COMMISSION’S REPLIES

**10.11.** *The Commission is considering ways to improve the presentation in the management plans of the linkages between the actions the services carry out and the intended results and impacts. The Commission considers that compliance with SMART criteria is sufficient in order to allow for appropriate monitoring of progress towards achieving the objectives. Moreover, impacts and results can often only be measured over a multiannual perspective.*

**10.12.** *When assessing the compliance with the SMART criteria, the information in the management plan should be analysed in its entirety.*

*The Commission recognises that performance reporting should focus on the real needs of stakeholders and should be sufficiently flexible to reflect the different nature of activities of the services.*

**Box 10.2 — Objectives DG MOVE**

Objective not SMART

For the objective on urban mobility, it will be considered to be attained by the number of cities that are members of the CIVITAS forum reaching 250-270 by 2015. All necessary information is therefore available to the reader and the objective can in practice be considered to be specific, measurable, achievable, relevant and timed, i.e. SMART.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.13. Milestones make it possible to check whether the achievement of a long-term goal is on track. Long-term targets should be accompanied by medium-term or annual milestones. In its 2012 MP, DG MARE set two milestones which were already achieved in 2011. For other milestones used by DG MARE the relevance to the achievement of the associated objectives was not obvious. DG MOVE used four milestones for objectives with targets in the future (2020 and 2050) in its 2012 MP. However, one of these targets which had a milestone set in 2012 was not reported on in the 2012 AAR without any explanation as to why not.

#### Indicators for monitoring performance need improvement

10.14. The choice of indicators should be based on considerations such as the relevance, measurability, and the availability of timely and reliable performance data. To the extent possible, such indicators should be established according to the 'RACER' criteria<sup>(14)</sup>. Indicators, which are measuring outcomes over which DGs have limited influence, should be accompanied by other indicators measuring directly the DGs' activities.

10.15. All three DGs have at least one performance indicator per objective to help management monitor, evaluate and report on achievements. An examination of 15 indicators (five for each DG) showed that eight of the indicators adequately fulfilled all the RACER criteria. In addition, the Court identified the following shortcomings (see box 10.3):

- (a) indicators which were outside the DGs' ability to influence (DG MARE, DG MOVE);
- (b) indicators which lacked relevant information (DG COMP) or a quantified target (DG MARE and DG COMP) or where a quantified target was available it could not be measured (DG MARE);
- (c) indicators with targets where the link between the indicator and the target was unclear or the target was not meaningful (DG MARE and DG MOVE).

**10.13.** Milestones only make it possible to check the extent to which the actions taken are moving towards the achievement of a long-term goal, thereby signalling if progress is advancing as planned.

As regards DG MOVE, in the Management Plan 2012 a long-term target (for 2020) and a milestone for 2010 were set for the impact indicator 'share of renewable energy in transport'. However, the legislation on which the milestone was based was repealed with effect from 1 January 2012 and thus the corresponding indicator was no longer reported in the AAR 2012. The Commission agrees that an explanation in the AAR 2012 would have been useful in clarifying why the level of the milestone for 2010 is included in the Management Plan 2012 but not in the AAR 2012.

**10.14.** The indicators should be relevant for the objectives they relate to. Where objectives are impact — or result-oriented, indicators measuring only the direct outcome of the DG are too restrictive to adequately monitor progress towards achievement of those objectives. The Commission considers that using only indicators measuring a direct outcome of a DG would be overly restrictive and not adequate to cover the wealth of its activities.

**10.15.** The Commission considers that the indicators presented generally provide useful information on progress towards attaining the Commission's overall policy objectives as well as for monitoring performance.

- (a) The Commission considers that the indicators present important information for communicating with external stakeholders and for providing an overall steer to the political initiatives and decisions of the Commission. The direct impact of a policy initiative on the attainment of an objective can often only be assessed in a medium or longer term perspective.
- (b) Please see reply to Box 10.3.
- (c) The Commission considers that the indicators presented are useful. It nevertheless agrees that information on the attainment of the targets for these particular indicators should be more clearly explained and will strive to do so in the future (see also reply to Box 10.3).

<sup>(14)</sup> Relevant, accepted, credible, easy and robust, Commission's internal control standard on objectives and performance indicators (ICS 5).

## THE COURT'S OBSERVATIONS

**Box 10.3 — Examples of indicators**

DG MARE — Indicators outside the control of the DG

There are indicators which fall outside of DG MARE's scope of influence as they rely on results of international trade negotiations. DG MARE mentions as a disclaimer that completion of these negotiations is not under its control.

DG COMP — No relevant information provided

The specific objective 'Effective detection, sanctioning, deterrence and remedying of the most harmful anti-competitive practices by undertakings other than cartels' is measured by one result indicator 'Benchmark for the (observable) customer benefits from Commission decisions prohibiting anti-competitive practices other than cartels and from Commission decisions making binding the commitments put forward by undertakings'. This indicator is defined according to a calculation methodology used by DG COMP which aims at quantifying estimated consumer benefits. However, DG COMP itself states that this indicator does not measure progress towards the achievement of the objective. Hence, the objective is without an indicator.

DG MOVE — Difficulties with presenting and interpreting its results

For the general objective 'modernise transport infrastructure and its smart funding' one of the impact indicators established by DG MOVE is 'reduction in (average) travelling time on 30 TEN-T priority projects due to improved infrastructure financed through EU funds' with the target of minus 20 % by 2020 (in comparison to 2011). The impact on the population is stated in quantitative terms as reduced travelling time. However, the way the latest known information is presented in the 2012 AAR is confusing. The current situation for this indicator is presented as follows: 'St-Pölten-Vienna: 40 min; Unterinntal: 15 min; Barcelona-France: 1 h 40 min'. It is unclear if this is the reduced average traveling time already achieved in 2012 or indeed the reduced average traveling time target for 2020. There is no information to what extent the target of the minus 20 % was achieved. In addition only three values out of 30 are presented. Without additional explanation it is not possible to determine whether the realisation of the objective as monitored by the indicator is on track.

## THE COMMISSION'S REPLIES

**Box 10.3 — Examples of indicators**

DG MARE — Indicators outside the control of the DG

The indicator on international trade negotiations under ABB 1102 is relevant for measuring progress towards the specific objective concerned, as it indicates the result of the work of the DG.

A disclaimer has been added in accordance with Part 4 of the Standing instructions from the central services on the Management Plan 2012.

DG COMP — No relevant information provided

The Commission acknowledges that DG COMP does currently not provide for an indicator for its activity relating to anti-competitive practices by undertakings other than cartels. This is due to the complexity of the calculation due to divergence of such cases compared to the more homogenous nature of the cases for instance for horizontal mergers or cartels implying a less complex calculation, and the incurring resource implication for such more complex calculation (cost-benefit).

DG MOVE — Indicator for reduction of travelling time

The Commission considers the indicator for the reduction of travelling time to be very relevant and particularly useful for the assessment of the achievement of the objective to modernise transport infrastructure. It however acknowledges that the progress on achieving the reduction of travelling time on 30 TEN-T priority projects (PPs) could have been more clearly explained and will strive to do so in the future.

On the stretches of the three priority projects mentioned, travelling times were shortened by 20-60 % in 2012 due to measures co-financed by the EU. As interventions on further sections will follow until 2020, the Commission expects that individual objectives will be met also for the entire stretches of these priority projects, as well as for other priority projects.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Evaluations have not been a useful source of evidence to substantiate reporting on policy achievements in AARs**

10.16. According to the Commission's standing instructions, evaluations and evaluation related studies should be a source of information on results and impact. All three DGs include some information on evaluations in part 1 of their 2012 AARs. However this information was brief or in footnotes. An examination of five evaluations completed in 2012 or earlier for each of the three examined DGs revealed that these were of limited value as sources of information on results and impact. This was largely due to the fact that evaluations were oriented towards operational questions rather than performance or because the Commission had doubts as to the quality of information obtained from Member State authorities.

**10.16.** *The Commission takes note of the Court's finding that the sample of evaluations, looked into by the Court, were oriented towards operational questions rather than performance. The Commission shares the view that evaluations should produce information on results and impacts, recognising that the focus of evaluations may differ depending the stage of implementation of the evaluated programme. The Commission refers to the Article 318 TFEU evaluation report in which results, covering all of the MFF Budget headings, are presented in relation to both operational issues during the early implementation of programmes as well as in relation to the impact, effectiveness, and EU value added of programmes at a later stage of implementation.*

*The Commission will pay increased attention to performance-related aspects in its evaluations and to the necessary reporting on this in the AARs. It points to examples of evaluations already providing useful information on policy achievements.*

*The Commission considers that it has made significant progress in recent years in reporting on policy achievements and that the Annual Activity Reports of its directorates-general contain a wealth of useful information on policy objectives, the results attained and their impact on society.*

*The Commission is working on a stronger and more coherent framework for monitoring, evaluation and reporting on the performance of EU financial programmes for the next MFF. The Article 318 Report on the year 2012 contains an Action Plan. The Commission recalls that the information and assessments that the Commission will be able to produce year-on-year in its Annual Activity Reports and in its overall reporting for the next MFF will largely depend on the provisions regarding performance in the legal instruments to be adopted by Parliament and Council to support the new set of financial programmes.*

**Performance management and reporting is evolving and some corrective actions have been taken but it is too early to assess their results**

10.17. SG and DG BUDG play a central role in providing annual instructions concerning the structure and content of AARs. In addition they exercise a central quality management (support and monitoring) over AARs prepared by the individual DGs. The quality control process included, for the first time in 2012, discussions of the draft AARs part 1 of all DGs with SG and DG BUDG.

## THE COURT'S OBSERVATIONS

10.18. In its audit of the AAR process, the IAS concluded that the process focuses on legality and regularity while economy, efficiency and effectiveness of policy achievements are not sufficiently addressed. In response to this audit the Commission established an action plan in March 2013 to address the main findings including a revision of the standing instructions.

10.19. In the context of the MFF negotiations the Commission has proposed a common performance framework for both the Commission and the national authorities which bases itself on agreed output and result indicators.

## PART 2 — EVALUATION REPORT ON THE UNION'S FINANCES BASED ON RESULTS ACHIEVED

10.20. The Commission published its second report in November 2012 and in June 2013 its third report on the evaluation of the Union's finances based on the results achieved (the evaluation report) <sup>(15)</sup>. The Treaty requires that the Commission produce such a report, and that the report is part of the evidence on which the Parliament gives a discharge each year to the Commission in respect of the budget <sup>(16)</sup>.

10.21. In its observations <sup>(17)</sup> on the second evaluation report the Court found the broader scope, compared to the first evaluation report, an improvement and noted that the report gives some indication as to the effectiveness and efficiency of the programmes. However, the evaluation report did not provide sufficient, relevant and reliable evidence on what the EU's policies have achieved and was therefore not suitable for its intended use in the discharge procedure.

10.22. Compared to the first and the second evaluation reports, the third report represents some improvements as it draws on more sources of information than just evaluation reports, notably the Court's special reports and recommendations of the Commission's Internal Audit Service, and also identifies some areas in need of improvement. The Court welcomes these developments. However, the evaluation report is not yet suitable for its intended use.

## THE COMMISSION'S REPLIES

**10.18.** *The Commission will revise the standing instructions on the preparation of the Annual Activity Reports. This revision will also ensure that economy, efficiency and effectiveness of policy achievements are addressed.*

**10.21.** *The Commission reiterates its intention to further improve the report in the future in discussion with the Discharge Authority.*

*The Commission also confirms that this can only be achieved under the new performance framework which will be based on the legal bases for the next MFF.*

*Account has been taken of the indications provided so far by the Court in the preparation of this year's evaluation report to the extent possible within the existing framework of the MFF 2007-13. This report was adopted on 26 June 2013.*

**10.22.** *The Commission welcomes the positive reception by the Court of the developments made in the evaluation report. At the same time, the Commission considers that it may only be possible for the evaluation report start to provide sufficient, relevant and reliable evidence on what EU policies have achieved, and therefore to be considered by the Court as suitable for its intended use in the discharge procedure, late in the MFF when the first indications on the impacts of the programmes start to appear.*

<sup>(15)</sup> Second evaluation report (COM(2012) 675 Final); third evaluation report (COM(2013) 461 Final).

<sup>(16)</sup> Articles 318 and 319 TFEU.

<sup>(17)</sup> Letter from the President of the Court to the President of the Commission: 'Response of the European Court of Auditors to the Commission's second Article 318 evaluation report', 21 December 2012 (<http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/Otherauditdocuments>).

## THE COURT'S OBSERVATIONS

10.23. The Court notes that the Commission has undertaken to present, in 2014, a new framework for performance reporting and notes the initiatives already taken in order to strengthen performance reporting in the Commission services. In addition, the Commission plans to:

- (a) improve performance reporting in the annual activity reports of its directorates-general;
- (b) make a closer link between the annual management plans and annual activity reports on the one hand and the Article 318 evaluation report on the other hand;
- (c) adopt the evaluation report in parallel with the synthesis report.

10.24. Finally, the third evaluation report is accompanied by an action plan for developing the Article 318 evaluation report. The Court recognises this as a positive step. However, it is not clear what the actions will mean in practice. In particular, the plan does not specify individual responsibilities or completion dates for the actions mentioned. The Court will follow-up and report on the extent to which the Commission succeeds in implementing the action plan and in delivering the improvements promised concerning future evaluation reports.

### PART 3 — RESULTS OF THE COURT'S AUDIT ON PERFORMANCE

#### Introduction

10.25. The Court's special reports examine whether the principles of sound financial management (paragraph 10.2) are applied to European Union spending. The Court chooses its topics for special reports — specific budgetary areas or management themes — to have maximum impact, based on a range of criteria, such as the level of income or spending involved (materiality), the risks to sound financial management and the degree of stakeholder interest. In 2012, the Court adopted <sup>(18)</sup> 25 special reports, as listed in **Annex 10.1**.

10.26. The Court examines in this part the lessons that can be learned from its 2012 special reports. The Court focuses on three themes which are important for obtaining the desired results and impacts of the next generation of spending programmes: SMART objectives and suitable indicators for programmes, reliable and timely data on the performance of programmes and sustainability of EU funded projects.

## THE COMMISSION'S REPLIES

**10.23.** On the basis of the new generation of spending programmes under the multiannual financial framework for the period 2014-2020, the Commission will instruct its services to reflect the performance framework of these programmes into their management plans for 2014. This will allow reporting on performance in the Annual Activity Reports to be issued in March 2015. In addition, a closer link will be created between the Annual Activity Reports of the directorates-general and the evaluation report based on Article 318 TFEU.

**10.24.** The Commission welcomes the Court's recognition that the Action plan is a positive step. It recalls the indication in this year's report that the Action plan remains provisional pending the adoption of the legal instruments that will support the financial programmes in the next MFF. This explains the absence of specific individual responsibilities and completion dates.

<sup>(18)</sup> Adopted means approved for publication.



## THE COURT'S OBSERVATIONS

10.27. These themes are also reflected, to a varying degree, in other recent publications from the Court <sup>(19)</sup>. As previously pointed out by the Court, and in order to establish whether European Union spending is having the desired results and impact, there is a need for the Commission to re-think its reporting and accountability systems for the forthcoming programming period and focus not only on compliance with the rules but also on the achievements of outcomes (results and impact). SMART objectives and suitable indicators along with reliable, timely information, are essential elements of such a reporting and accountability system.

### **SMART objectives together with suitable performance indicators not consistently applied in spending programmes**

10.28. The Financial Regulation requires that the achievement of SMART objectives set for all sectors of activity covered by the budget be monitored by performance indicators <sup>(20)</sup>. This would allow the Commission and Member States to evaluate not only at the end but also at key intermediate points whether the defined objectives have been met and whether intended impacts are likely to be achieved.

## THE COMMISSION'S REPLIES

**10.27.** *The Commission agrees that its management systems should be adequately set in order to measure the achievements and outcomes of the EU spending and that appropriate follow-up and control systems should be in place to obtain reliable information for reporting on results.*

*The Commission is working on developing its internal management system in the context of the upcoming 2014-2020 multiannual financial framework (MFF) with a particular focus on EU added-value, efficiency and effectiveness and overall impacts on the economy and society of its spending programmes. The Commission will design a new culture of performance using the objectives, indicators, monitoring and evaluation frameworks set by the Legislative Authority for the coming programming period; this will also provide a clear basis for the annual reporting on performance by the Commission.*

*The Commission has already included in its proposals for the new programmes under the MFF several elements aimed at delivering a stronger performance framework, which would be more focused on efficiency and effectiveness in the attainment of the overall objectives of the different financial programmes. This performance framework will impact on the existing internal management instruments.*

<sup>(19)</sup> Opinion No 4/2012 on the Commission's evaluation report on the Union's finances based on results achieved established under Article 318 of the Treaty on the Functioning of the European Union (<http://eca.europa.eu>). See also Opinions No 7/2011 on the proposal for a Regulation of the European Parliament and of the Council 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 covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006 and No 1/2012 on certain proposals for regulations relating to the common agricultural policy for the period 2014-2020, as well as the annual report concerning the financial year 2010, paragraph 8.54, Response of the European Court of Auditors to the Commission's second Article 318 evaluation report.

<sup>(20)</sup> Article 30(3) of the Financial Regulation.

## THE COURT'S OBSERVATIONS

10.29. In its special report on integration of third-country nationals, the Court found that the Commission has demonstrated that it is possible to define indicators relating to the output and outcomes of funded actions <sup>(21)</sup>. The examined authorities in Member States were required to include quantifiable outputs. However, measurable targets were only specified for around half of the actions examined and most of these cases referred simply to the number of projects or participants instead of specific aspects such as the success rate in obtaining qualifications. The Court concluded that although the Commission provided extensive guidance on indicators, four out of the five Member States showed significant weaknesses in the inclusion of SMART objectives in programmes, setting up appropriate IT collection systems and/or reporting on the achievement of targets. Consequently, the ability of Member States and the Commission to monitor and steer the programmes has been hampered.

10.30. The special report on the reform of the wine market showed that despite thorough information requirements and the Commission receiving a large amount of information from Member States on the implementation of the various measures, the Commission's monitoring role, which should include an assessment of whether the reform is meeting its objectives, was limited by the absence of key performance indicators <sup>(22)</sup>.

## THE COMMISSION'S REPLIES

**10.29.** Under the European Fund for the Integration of third country nationals, the Commission is using several instruments to monitor national programmes, such as regular contacts with Member States and intermediate and closure implementation reports. In addition, Member States have submitted national evaluation reports covering the period 2007-2010 on the basis of common indicators set by the Commission and compatible with the Member States' own indicators at project level. These common indicators should produce meaningful results at national and European level. In its proposal for a Regulation for the Asylum and Migration Fund of 15 November 2011 (COM(2011) 751 final), the Commission has proposed to have common compulsory indicators to assess and to manage efficiently the national programmes. They are already being discussed with participating Member States, in particular as regards the fact that they should be limited in number and 'SMART', linked to reality and providing reliable data.

**10.30.** The assessment of whether the wine Reform of 2008 meets its objective is carried out by the Commission on the basis of the following elements:

(1) Periodical assessment of the wine market situation:

(a) based on key indicators provided for in Regulations (EC) No 555/2008 and (EC) No 436/2009.

(2) Periodical assessment of the implementation by Member States of wine policies for example:

(a) a study on the implementation of the reform carried out in 2012, which provided a substantial and detailed analysis on different aspects of the wine common market organisation;

(b) as regards national programmes, Regulation (EC) No 555/2008 was modified and two guidelines were respectively approved in 2013 by DG AGRI with the view to clarifying and detailing how these measures have to be implemented at national level. These guidelines recommend to Member States key indicators to be used (e.g. selection criteria, evaluation criteria, impact indicators, etc.). These indicators are also used by DG AGRI when evaluating its policies.

<sup>(21)</sup> Special Report No 22/2012 'Do the European Integration Fund and European Refugee Fund contribute effectively to the integration of third-country nationals?', paragraphs 20, 24, 25 and 79.

<sup>(22)</sup> Special Report No 7/2012 'The reform of the common organisation of the market in wine: Progress to date', paragraphs 50 and 57.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.31. The Court's special report on financial instruments co-financed by the ERDF points out that the standard cohesion policy monitoring instruments put in place for the ERDF are inadequate or not adapted for the purpose of financial instruments. It concluded that where they existed, monitoring and information systems were ill-equipped to provide information on and monitor the sound financial management of the funds <sup>(23)</sup>.

### Deficiencies in the relevance, reliability and timeliness of performance data

10.32. Measuring and assessing achievement of objectives is however only meaningful if based on information which is relevant, reliable and timely. In building a robust performance management and reporting system, the Commission needs to give particular attention to the reliability and timeliness of the performance data that it generates or obtains from Member States and third parties. A number of the Court's 2012 special reports provided examples of deficiencies in the quality of data and some examples are given in the following paragraphs.

#### (3) Broader evaluations of wine issues:

- (a) the data collected throughout 2012 was also used by DG AGRI for the drafting of the 2012 report to Council and Parliament, in combination with other indicators provided for by Member States relating to national support programmes and to the grubbing-up scheme;
- (b) DG AGRI is currently launching a new evaluation on the competitiveness of EU wines, which should be completed by the end of 2014. The proposed tender establishes clear indicators for this up-coming evaluation;
- (c) DG AGRI is carrying out another evaluation on the added-value of protected designations of origin and protected geographical indications. Again, this later establishes clear indicators.

**10.31.** The amendment of Council Regulation (EC) No 1083/2006 in December 2011 introduced an obligation for Member States to formally report on financial instruments. In 2012, the Commission produced on this basis a summary report and the Commission services have also developed a detailed guidance on reporting for managing authorities. In addition, in February 2012 the Commission published a Staff Working Document on financial instruments in cohesion policy and carried out an evaluation through the expert evaluation network on the use of the ERDF to support financial instruments. The reporting requirements will be further consolidated in the next programming period.

**10.32.** For the programmes in the area of direct management, the Commission should be able, according to its legislative proposals for the next funding programmes to ensure timely and reliable information for reporting on their performance.

For the programmes under indirect management the Commission has to rely on the willingness and capacity of Member States and third parties for providing adequate, timely, reliable and comparable data. This is not possible across all the programmes in a synthetic way under the current legal framework.

<sup>(23)</sup> Special Report No 2/2012 'Financial instruments for SMEs co-financed by the European Regional Development Fund', paragraphs 82 and 121.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.33. In its audit on targeting the aid for modernisation of agricultural holdings, the Court found that the Common Monitoring and Evaluation Framework — set up as a tool for the Member States and the Commission — did not generate relevant data which can be used for monitoring the results obtained with the funds spent. The indicators defined did not allow progress in the achievement of the EU's priorities to be monitored, and the data were found to be of low reliability and did not allow comparisons between Member States (and/or regions) to be made <sup>(24)</sup>. In another report, the Court noted significant weaknesses regarding the reporting by Member States, resulting in the inability of the Commission to evaluate in all cases whether the performance being achieved by Member States was in line with EU waste targets. While the Commission checked the consistency of the figures received, it did not assess their reliability <sup>(25)</sup>.

10.34. Shortcomings in reporting systems can also have a negative impact upon the reliability of information. The audit of the Common External Relations Information System (CRIS) — the information system put in place by the Commission to support the financial and operational aspects of the management of external actions — identified problems with regard to the integrity of the data in this system. The Court found records where information was missing, not valid or not up-to-date. These undermined the system's reliability and its efficiency and effectiveness as a management tool <sup>(26)</sup>.

For the programmes under shared management, the Commission proposed to the Legislative Authority some key requirements for the design of the systems to produce information on results in the frame of the future regulations post 2013. The responsibility for operating those systems in order to provide complete and accurate information on results lies with the Member States in line with the division of competences under shared management.

**10.33.** The Commission considers that the Common Monitoring and Evaluation Framework constitutes a relevant and integrated set of indicators that was jointly prepared by the Commission and Member States to capture the policy's objectives. It marks the first time that a comprehensive, yet very demanding, monitoring and evaluation system for rural development was implemented at EU-level. It is the combination of all the measures which should be considered when assessing whether EU's priorities are well addressed.

Measure 121 should be assessed against the objective of improving competitiveness. The current 'learning by doing' experience shows that the definition of result indicators in this field is challenging and the Commission, Member States and various stakeholders have devoted much effort to continuously improve methodology, reliability and comparability. This experience will also be used for the future monitoring and evaluation system.

**10.34.** Efforts are under way to address those shortcomings, but no financial and/or other critical information is missing in CRIS. In addition to the progress that was mentioned in the CRIS audit as regards data quality issues (nomination of data owners, creation of a data quality team and implementation of a data quality governance), the following projects have recently been launched:

- rationalisation of geographical codes,
- improvement of CRIS user interface on the basis of the analysis of encoding error cases,
- a number of cleansing actions, resulting from audit findings, monitoring procedures and reporting exercises.

The above projects are part of a newly defined data quality master plan including actions covering data cleansing, information system improvement, monitoring and control, user documentation and training.

<sup>(24)</sup> Special Report No 8/2012 'Targeting of aid for the modernisation of agricultural holdings', paragraph 70.

<sup>(25)</sup> Special Report No 20/2012 'Is Structural measures funding for municipal waste management infrastructure projects effective in helping Member States achieve EU waste policy objectives?', paragraph 73.

<sup>(26)</sup> Special Report No 5/2012 'The Common External Relations Information System (CRIS)', paragraph 79.

## THE COURT'S OBSERVATIONS

10.35. The audit of the suckler cow and ewe and goat direct aid also showed that monitoring of performance indicators was weak in most Member States due to the lack of an ad hoc performance monitoring system for measuring the results and outcomes of the audited schemes, and due to the different interpretations of the terms 'production' and 'supply to the processing industry' by each Member State. An additional constraint in the monitoring by the Commission was the lack of an appropriate tool providing a global view of the aids that are available from different sources. In addition, the rapid pace of recent CAP reforms did not always enable precise quantitative assessments to be made in a timely manner<sup>(27)</sup>.

10.36. Timeliness when reporting performance data has proven to be an issue as the shortcomings in the collection and registration of the monitoring data for the European Social Fund spending on older workers demonstrates. Not having access to reliable, verifiable and timely performance data and assessments of the different actions impeded the drawing of conclusions for current and future decision making<sup>(28)</sup>.

## THE COMMISSION'S REPLIES

**10.35.** The legislator has considered that these concepts could be better defined at national level.

The Commission has an overall view of the situation across the EU regarding the various coupled support measures applied in the animal sectors. Member States are subject to the obligation to periodically notify the Commission on the number of animals and the amounts paid under both coupled suckler cow and sheep and goat payments and coupled Article 68 payments, as well as under complementary national direct payments (CNDP) implemented in the Member States who joined in 2004 and 2007. As far as social, economic and environmental impacts of the schemes, the Commission considers that it is more a matter for evaluation than monitoring.

When it comes to the decision making process for the upcoming reform, the Commission bases its proposals on an impact assessment which draws on a whole range of information sources, quantitative analyses, qualitative and quantitative information from the literature and public consultations' evaluation reports are one of these information sources.

As for the future, the Commission proposal for the CAP towards 2020 foresees the establishment of a common monitoring and evaluation framework with a view to measuring the performance of the common agricultural policy, including first and second pillar measures.

**10.36.** The current regulatory framework for ESF imposes the collection of data at priority axis level, not at the far more detailed target group level. The suggested line would be very complex to implement (for example most projects include de facto many different target groups), place an important burden on Member States and beneficiaries, and entail a considerable cost.

Information on results and in particular impact can be obtained through evaluations. For example, the Evaluation of the ESF support to Lifelong Learning, finalised in July 2012, focused inter alia on older workers. The Commission estimates that data available through such evaluations are vital and allow drawing conclusions on the effectiveness of ESF interventions.

Nevertheless, the Commission acknowledges that improvements can be made. Therefore, for the next programming period 2014-2020, the Commission aims to address, through the new legislative package, a number of weaknesses identified in the domain of monitoring and evaluation arrangements.

<sup>(27)</sup> Special Report No 11/2012 'Suckler cow and ewe and goat direct aids under partial implementation of SPS arrangements', paragraphs 63 and 64.

<sup>(28)</sup> Special Report No 25/2012 'Are tools in place to monitor the effectiveness of European Social Fund spending on older workers', paragraph 61.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**In several cases sustainability of EU projects was at risk**

10.37. A public intervention should ideally be sustainable i.e. it should not only focus on short-term outputs but also continue to deliver results and achieve impacts after the external funding has stopped. Sustainability should therefore be an important factor to consider when designing a programme and/or project. Considerations in this regard should include issues such as financial sustainability, technical sustainability and institutional capacity, as well as the interdependence of these elements.

10.38. Eight reports identified sustainability as an issue in 2012. Five of these eight reports related to the assistance provided to non EU countries and territories. The remaining three reports touch upon the sustainability of projects financed under shared management thus providing an indication that this subject is relevant beyond the development aid area. Meanwhile, in six of these eight reports a risk was identified that projects might cease and benefits might not continue to flow in the absence of continuous funding <sup>(29)</sup>.

10.39. Under shared management, the Member State authorities are primarily responsible for selecting projects which are financially sustainable. The Court's audit of EU support to the implementation of hygiene legislation in slaughterhouses showed that project sustainability was an objective as funded projects should be maintained at target levels of activity for at least five years after the end of the investment. However, the audit also showed cases in each of the five Member States covered by the audit where either the five year minimum period of activity or where the targeted levels of activity were not achieved. This diminished the impact of the funds used to facilitate compliance with hygiene requirements in the slaughterhouses <sup>(30)</sup>.

**10.39.** *The impact of the funded investments on meeting the new hygiene standards was subject of a review by the ex-post evaluation reports of the Sapard programmes of eight beneficiary countries which joined the EU in 2004. The synthesis report of these evaluations by independent evaluators concluded under Chapter 4.2.1 'Meeting EU standards and acquis communautaire: The most important impacts were reached in the field of hygiene, sanitary and veterinary conditions and environment'. The report was published and can be found under:*

*[http://ec.europa.eu/agriculture/evaluation/rural-development-reports/index\\_en.htm](http://ec.europa.eu/agriculture/evaluation/rural-development-reports/index_en.htm)*

<sup>(29)</sup> Special Reports No 1/2012 'Effectiveness of European Union development aid for food security in Sub-Saharan Africa', No 6/2012 'European Union Assistance to the Turkish Cypriot Community', No 8/2012 'Targeting of aid for the modernisation of agricultural holdings', No 13/2012 'European Union Development Assistance for Drinking-Water Supply and Basic Sanitation in Sub-Saharan Countries', No 14/2012 'Implementation of EU hygiene legislation in slaughterhouses of countries that joined the EU since 2004', No 17/2012 'The European Development Fund (EDF) contribution to a sustainable road network in sub-Saharan Africa', No 18/2012 'European Union Assistance to Kosovo related to the rule of law' and No 23/2012 'Have EU Structural Measures successfully supported the regeneration of industrial and military brownfield sites?'.

<sup>(30)</sup> Special Report No 14/2012, paragraphs 48 and 49.

## THE COURT'S OBSERVATIONS

10.40. In its audit of development aid for drinking water supply and basic sanitation in sub-Saharan countries the Court found that projects examined were technically sustainable: they promoted the use of standard technology and locally available materials. However, for a majority of projects results and benefits will not continue to flow in the medium and long-term unless non-tariff revenue can be ensured. Despite comprehensive management procedures, the Commission did not tackle important matters regarding sustainability <sup>(31)</sup>.

10.41. In its audit of brownfield site regeneration, the Court observed that all the brownfield site regeneration projects examined had some of the key characteristics which are considered to be best practices for assuring the sustainability of sites and outcomes in the long-term <sup>(32)</sup>. For example, some sites were strategically located and were served by tri-modal transport networks (road, rail and waterways) and all sites were adequately served by transport, sanitation and information and communication technology infrastructure.

10.42. Even when interventions are financially and technically sustainable, results might not be long-lasting if beneficiaries do not get involved and develop a sense of ownership or where the institutional capacity is insufficient.

10.43. Through both the Instrument for Pre-Accession Assistance and its Common Security and Defence Policy, the EU provides support to Kosovo to strengthen the rule of law. Political support from the Kosovo authorities is a key condition for the sustainability of the results. However, the national authorities' commitment to the rule of law is open to question. Overall, the durability of results which have been achieved by the assistance is threatened by a lack of political will, weak financial capacity and the limited influence of civil society <sup>(33)</sup>.

## THE COMMISSION'S REPLIES

**10.40.** To address institutional sustainability issues, the Commission supports extensive capacity-building and training activities to empower water user associations and local authorities to own, manage and operate their installations, sometimes with the support of the private sector. The Commission also works at country level in the framework of sector reform programmes to support the development of appropriate sector policies and institutional framework whereby decentralised structures are set up to help local stakeholders in the long-run.

Establishing the water sector on a financially sustainable basis requires establishing the appropriate balance between tariffs, transfers and taxes. For most countries, operating costs cannot be covered by tariffs only. This is true in Europe and even more in sub-Saharan countries, where projects mostly target the most vulnerable groups with very limited capacity to pay. For this reason, the Commission supports the process of developing social tariffs while ensuring the financial sustainability of the sector as a whole through sector dialogue with beneficiary countries.

**10.41.** The Commission welcomes the Court's analysis.

**10.43.** The Commission and the EEAS share the Court's assessment. They aim to remedy the weaknesses identified through the increased use of policy dialogues as recommended by the Court, including with civil society, as well as by better coordination and synchronisation of EU policy objectives, instruments and assistance. This should help make EU action more efficient, effective and sustainable.

<sup>(31)</sup> Special Report No 13/2012, paragraphs III and 61.

<sup>(32)</sup> Special Report No 23/2012, paragraph 32.

<sup>(33)</sup> Special Report No 18/2012, paragraphs 62 and 102.

## THE COURT'S OBSERVATIONS

10.44. Similarly, the audit of the European Union assistance to the Turkish Cypriot community also showed that sustainability was at risk. This was due to limited administrative capacity, the delayed adoption of relevant measures and uncertainties over future funding <sup>(34)</sup>.

## CONCLUSIONS AND RECOMMENDATIONS

## Conclusions

10.45. For many areas of the EU budget the legislative framework is complex and there is lack of focus on performance. Proposals for the new CSF regulations and the CAP regulations for the 2014-2020 programming period risk remaining fundamentally input-based (expenditure oriented) and therefore oriented towards compliance rather than performance (see paragraphs 10.3 to 10.4).

## THE COMMISSION'S REPLIES

**10.44.** *The Commission has integrated measures into the 2012 and draft 2013 programmes to ensure completion and sustainability of existing projects. This includes continued training and assistance on setting up operation and management systems and also complementary investments to insure the Turkish Cypriot community (TCc) is properly equipped to deal with take-over and running of new plant. A very cautious approach is taken to new investments and is suspended in some areas pending efficiency actions by the TCc.*

*The delayed adoption of relevant procedures and legal texts by TCc has been identified by the Court of Auditors as a risk to sustainability. In these cases, the Commission continues to encourage the TCc to continue their work and delivers support in relevant areas.*

*To address the uncertainties over future funding, the Commission has prepared a proposal for a multiannual perspective under the 2014-20 MFF. This should help to provide a more stable level of funding for operations under the Aid Regulation.*

**10.45.** *The Commission shares the Court's views that the current legislative framework is complex and lacks focus on performance. This is why it has made all efforts that its proposals for the new generation of programmes under the multiannual financial framework 2014-2020 contain a strong performance framework, based on a clear definition of SMART objectives, using appropriate indicators allowing to report not only on the outputs but also on the results and impacts of spending programmes. It very much hopes that this framework will be maintained in the legislative process currently on-going between the European Parliament and the Council in view of the final adoption of the legal bases.*

*The new regulations for the CAP include important new elements to ensure a more result-oriented approach (see reply to point 10.3):*

- *the new direct payments have been designed to address specific needs and objectives (environmental objectives, young farmers, areas with natural constraints, etc.),*
- *the EAFRD draft regulation requires that each rural development programme (RDP) should be constructed around the achievement of quantified targets, which are strictly related to the objectives laid down in the regulation. If a RDP manifestly fails to achieve preset milestones, a performance reserve will not be released (see reply to point 10.4).*

<sup>(34)</sup> Special Report No 6/2012, paragraphs 45, 47 and 60.



## THE COURT'S OBSERVATIONS

10.46. In the context of the MFF negotiations the Commission has proposed a common performance framework for both the Commission and the national authorities which bases itself on agreed output and result indicators. However, an important factor for the future success in this area is its successful implementation by the Commission and the Member States (see paragraph 10.19).

10.47. The examination of the three DGs' AARs leads to the conclusion that AARs' reporting on policy achievements is evolving but it is still of limited use. The Court identified shortcomings in objectives and indicators as main issues (see paragraphs 10.9 to 10.16). The observations in the corresponding chapters in the Court's two previous annual reports are similar to this year.

10.48. The Article 318 evaluation report continues to be a work in progress and is not yet suitable for its intended use in the discharge procedure. The Court recognises the Commission's commitment to strengthen the performance culture within the Commission and to develop a reliable and robust performance management and reporting system. Towards that end, the Commission will present, in 2014, a new framework for performance reporting for the next MFF. Furthermore, the Commission has taken initiatives to strengthen and streamline its services reporting on performance in the remainder of the current programming period (see paragraphs 10.20 to 10.24).

## THE COMMISSION'S REPLIES

*As regards the proposed Regulations for the European Structural and Investment Funds, result-orientation has been included as an essential feature. The demanding and innovative proposals include:*

- *a reinforced intervention logic that links objectives set by the Union with binding and precise objectives by the Member States,*
- *for the first time intervention-specific ex ante conditionalities to improve the effectiveness of investments,*
- *decisively extended macroeconomic conditionalities,*
- *a renewed approach to evaluation, based on planning, the obligation to evaluate the impact of each part of the programme, and the use of new methods, and*
- *an obligatory performance framework including a performance reserve.*

**10.46.** *The Commission notes that for all programmes under shared management, the responsibility for implementing the common performance framework lies primarily with the Member States which are responsible for the daily management of the programmes, their monitoring and the reporting on results.*

**10.47.** *The Commission considers that it has made significant progress in recent years as regards reporting on policy achievements and that notably the Annual Activity Reports of its Directorates-General contain a wealth of useful information on policy objectives, the results attained and their impact on society. The indicators presented generally provide useful information on progress towards attaining the Commission's overall policy objectives as well as for monitoring performance.*

**10.48.** *The Commission recognises that the report continues to be a work in progress, with a strong focus each year on possible improvements for each following year. However, it doubts that the report can fulfil any intended use in the discharge procedure to start to provide reliable evidence on what EU policies have achieved before late in the MFF.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.49. As in previous years, in its performance audit work published in its 2012 special reports, the Court has identified weaknesses affecting the entirety of a typical management life-cycle. In the three specific areas analysed this year, the Court found that there are weaknesses in essential elements of the performance management and reporting system: SMART objectives and suitable indicators are not consistently employed in spending programmes, there are deficiencies in the quality and timeliness of performance data and the sustainability of projects financed by EU spending is often not ensured. It is important to address these issues if the desired results and impacts are to be obtained from the next generation of spending programmes (see paragraphs 10.25 to 10.44).

### Recommendations

10.50. **Annex 10.2** shows the result of the Court's review of progress in addressing recommendations made in the 2010 annual report. In the 2010 annual report (chapter 8), the Court presented six recommendations. All six recommendations were implemented in some respects. This assessment of the progress is based on:

(a) some positive developments in central guidance and quality management (for example improved instructions for the 2013 MPs and improved quality control of part 1 of the 2012 AARs);

(b) the remaining substantial shortcomings in the AARs examined; and

(c) the weaknesses identified in the Court's special reports.

**10.50.**

**(b)** *The Commission is pursuing its efforts to improve the Annual Activity Reports. These will aim to:*

- *include more elements of performance management: setting objectives, performance indicators and associated targets at the level of each programme,*
- *deepen the reporting on how financial and human resources have been used to achieve the policy objectives set by the College, and on how these policies have generated EU added value,*
- *strengthen the internal peer-review process on the Annual Activity Reports, including increased focus on the performance information.*

## THE COURT'S OBSERVATIONS

10.51. Following this review and the findings and conclusions for 2012, the Court recommends that:

- **Recommendation 1:** the Commission and the legislator should ensure that there is a focus on performance in the forthcoming programming period (2014-2020). This requires that a limited number of sufficiently specific objectives with relevant indicators, expected results and impacts are laid down in the sector-specific regulations or in some other binding manner;
- **Recommendation 2:** the Commission should ensure that there is a clear link between the DGs' activities and the objectives set. When identifying these objectives each DG should take into account the relevant management mode, where applicable, and its role and responsibilities.

## THE COMMISSION'S REPLIES

**10.51.**

*The Commission proposals for the programmes under the next multi-annual financial framework focus on delivering on key policy priorities and on performance. They included elements of an enhanced performance framework in the form of provisions on objectives and indicators, monitoring arrangements, evaluation and reporting requirements. However, under the ordinary legislative procedure, both the Council and the European Parliament have the final responsibility for the adoption of the legal basic acts.*

*The Commission is operating in a political environment. The policy objectives it is pursuing are therefore multi-causal and often conditioned by the external environment in which the Commission services operate.*

*Objective-setting is mostly driven by policy and not by the management modes, as stated by the Court.*

*Furthermore, the Commission proposals for the next generation of programmes contain provisions setting out their expected contribution to the achievement of the political objectives of the Union.*



## ANNEX 10.1

SPECIAL REPORTS ADOPTED BY THE COURT OF AUDITORS IN 2012 <sup>(1)</sup>

- No 1/2012 'Effectiveness of European Union development aid for food security in Sub-Saharan Africa';
- No 2/2012 'Financial instruments for SMEs co-financed by the European Regional Development Fund';
- No 3/2012 'Structural funds: did the Commission successfully deal with deficiencies identified in the Member States' management and control systems?';
- No 4/2012 'Using Structural and Cohesion Funds to co-finance transport infrastructures in seaports: an effective investment?';
- No 5/2012 'The Common External Relations Information System (CRIS)';
- No 6/2012 'European Union Assistance to the Turkish Cypriot Community';
- No 7/2012 'The reform of the common organisation of the market in wine: Progress to date';
- No 8/2012 'Targeting of aid for the modernisation of agricultural holdings';
- No 9/2012 'Audit of the control system governing the production, processing, distribution and imports of organic products';
- No 10/2012 'The effectiveness of staff development in the European Commission';
- No 11/2012 'Suckler cow and ewe and goat direct aids under partial implementation of SPS arrangements';
- No 12/2012 'Did the Commission and Eurostat improve the process for producing reliable and credible European statistics?';
- No 13/2012 'European Union Development Assistance for Drinking-Water Supply and Basic Sanitation in Sub-Saharan Countries';
- No 14/2012 'Implementation of EU hygiene legislation in slaughterhouses of countries that joined the EU since 2004';
- No 15/2012 'Management of conflict of interest in selected EU Agencies';
- No 16/2012 'The effectiveness of the Single Area Payment Scheme as a transitional system for supporting farmers in the New Member States';
- No 17/2012 'The European Development Fund (EDF) contribution to a sustainable road network in sub-Saharan Africa';
- No 18/2012 'European Union Assistance to Kosovo related to the rule of law';
- No 19/2012 '2011 report on the follow-up of the European Court of Auditors' Special Reports';
- No 20/2012 'Is Structural measures funding for municipal waste management infrastructure projects effective in helping Member States achieve EU waste policy objectives?';
- No 21/2012 'Cost-effectiveness of Cohesion Policy Investments in Energy Efficiency';
- No 22/2012 'Do the European Integration Fund and European Refugee Fund contribute effectively to the integration of third-country nationals?';
- No 23/2012 'Have EU Structural Measures successfully supported the regeneration of industrial and military brownfield sites?';
- No 24/2012 'The European Union Solidarity Fund's response to the 2009 Abruzzi earthquake: The relevance and cost of the operations';
- No 25/2012 'Are tools in place to monitor the effectiveness of European Social Fund spending on older workers'.

<sup>(1)</sup> The ECA's special reports are available on the Court's website at:  
<http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/specialreports>.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR GETTING RESULTS FROM THE EU BUDGET

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	<b>Recommendation 1:</b> Increased focus should be put on performance in the DG annual activity reports, in particular by analysing differences between planned targets and achievements as well as by reporting on the economy and efficiency of EU funding (see paragraph 8.53).			X				As from the 2012 AAR, services are required to include in Part 3 of the AAR key indicators of sound financial management (effectiveness, efficiency, economy) of the EU funding, and report the results of such indicators on an annual basis. Respectively, these indicators could be based on, e.g., the quality results (% of decisions challenged) of the project selection processes, the time-to-pay statistics, and the financial savings made during the contracting process.
	<b>Recommendation 2:</b> The Commission services should define appropriate interim milestones for multi-annual targets, so that progress can be assessed adequately (see paragraph 8.54).			X				For output, result and, where appropriate, impact indicators, interim milestones could indeed be defined (e.g. at least by checking the 'trend') . For outputs, it is possible to define milestones for multi-annual targets at least at programme level. Furthermore, within the preparatory works for the next financial framework, the Commission included in all its legislative proposals some further requirements to improve the quality of the planning phase: definition of general and specific objectives and related indicators.
	<b>Recommendation 3:</b> The Commission and the Member States within the context of their respective responsibilities under shared management should agree on consistent performance indicators and ensure the reliability of information on planned targets and achieved results (see paragraph 8.56).			X				The Commission is taking the recommended action and it has already engaged such a process with Member States. The recommendation will be implemented until the beginning of the next programming period.
	<b>Recommendation 4:</b> During the planning of EU expenditure programmes, the Commission and the Member States should pay greater attention to defining SMART objectives, as well as to identifying and mitigating the risks which may occur during implementation (see paragraph 8.57).			X				The Commission always endeavours to define SMART objectives. Some of the SMART-criteria may only be met once analysed together with the related indicators or other information in the management plans. The Commission has done specific efforts such as the guide on setting objectives and indicators attached to the instructions.

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	<b>Recommendation 5:</b> Accountability of the management should also be understood to include reporting on results with a correspondence between achievements expected in the management plan and achievements reported in the annual activity report (see paragraph 8.58).			X				<p>The standing instructions for the Management Plans and for the Annual Activity Reports have been updated to enhance the correspondence between the objectives-related expectations and the achievements, and to explain any divergences (cf. the 'gap analysis'). The instructions on the 2013 Management Plans prescribe to have a baseline when defining general objectives (see part 3; 'current situation') as well as specific objective (see part 4: 'latest known results').</p> <p>During the AAR Peer Review Process on the 2012 AARs, the central services have provided to each group of DGs a table showing the comparability between the objectives and indicators as presented in the 2012 Management Plans.</p>
	<b>Recommendation 6:</b> The Commission, together with the Members States where appropriate in the context of shared management, should design and operate monitoring and control systems to produce complete and accurate information on results (see paragraph 8.58).			X				<p>For the programmes under shared management, the Commission proposed to the Legislative Authority some key requirements for the design of the systems to produce information on results in the frame of the future regulations post 2013. The responsibility for operating those systems in order to provide complete and accurate information on results lies with the Member States in line with the division of competences under shared management. See as an example COM(2011) 615 of 14 March 2012, proposal for a regulation on the common provisions applicable to the structural funds, in particular article 9 on thematic objectives, article 47 on evaluation and annex 1 on the method for establishing a performance framework.</p>

