

EUROPEAN COURT
OF AUDITORS

INFORMATION NOTE

Introducing and explaining the
2010 annual reports

2010 ANNUAL REPORTS

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PRESIDENT'S FOREWORD



This information note sets out the **key findings and conclusions** of the 2010 annual reports of the European Court of Auditors (ECA) on the implementation of the EU budget and the European Development Funds (EDFs) for the 2010 financial year.

This is the 17th year that the ECA publishes its **statement of assurance** - *Déclaration d'assurance* (DAS) - on the reliability of the accounts and the regularity of the transactions underlying them. The audit work necessary to produce the DAS represents a challenge to the ECA because of its scale. We audit the different and often complex revenue and spending schemes at all levels of

EU, national and regional administrations through to individual beneficiaries – of which there are millions – across the European Union and beyond.

Our aim is to provide soundly evidenced results which give a good basis for assessing – and ultimately improving – the management of the EU and EDF budgets. Over the past 17 years we have developed and refined our approach to the audit, as well as the way we report the results. 2010 is no exception. You will notice a number of **changes** in the 2010 annual report, including:

- a revision in the presentation and composition of the **policy groups** (and related chapters) into which the ECA groups expenditure, to ensure a more rational and better balanced distribution between them;
- increased clarity in the way we report the results of testing, with the inclusion of estimated **error rates** for each policy group and the budget as a whole;
- an enhanced focus on **recommendations** for improving financial management, notably by systematically reporting on the follow-up given to previous recommendations; and
- a new chapter on **performance issues**, reflecting the importance of the economy, efficiency and effectiveness of spending.

I hope that you find our 2010 annual reports of interest. As the independent external auditor of the EU finances, our aim is to produce objective and relevant audit reports and opinions which contribute to **improving financial management** of the European Union for the benefit of its citizens. Effective public spending is even more important in the current financial climate. The ECA will continue to promote transparency and accountability in EU revenue and spending.

For more information on our mission, work and results, see www.eca.europa.eu.



Vítor Manuel da SILVA CALDEIRA
President of the European Court of Auditors

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2010 ANNUAL REPORT – KEY MESSAGES

- The 2010 **accounts** present fairly the financial position of the European Union and the results of its operations and its cash flows for the year.
- In contrast, the **payments** underlying these accounts were affected by material error, with an estimated error rate of 3,7 % for the EU budget as a whole. Overall, the **control systems** were partially effective in ensuring the regularity of payments.
- The ECA's estimated error rate for spending in **Cohesion, energy and transport** policy group (the most error prone EU spending area) was higher than for 2009, with an estimated error rate of 7,7 %.
- For the **other areas of EU spending** the estimated error rate remained relatively stable. For the **Agriculture and natural resources** policy group the estimated error rate was 2,3 %, i.e. over the materiality level. However, the direct payments covered by the Integrated Administrative Control System (IACS) were free from material error.
- The proportion of advance payments – **pre-financing** - in the EU budget has risen considerably. The accounting rules and supervision have not been adjusted adequately.
- When **planning EU spending programmes**, the Commission and the Member States should pay greater attention to defining objectives that are SMART – specific, measurable, achievable, relevant and timed - as well as to identifying and mitigating the risks to implementation.



STATEMENT OF ASSURANCE

RELIABILITY OF 2010 ACCOUNTS

In the ECA's opinion, the annual accounts of the European Union present fairly, in all material respects, the financial position of the Union as of 31 December 2010, and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of the Financial regulation and the accounting rules adopted by the Commission's accounting officer.

Emphasis of matter

Without calling into question the opinion expressed above, the ECA draws attention to a change in the Commission's accounting policy concerning pre-financing payments establishing or contributing to Financial engineering instruments, which have not yet been used in the form of loans, guarantees or equity investments. This required the Commission to restate the 2009 annual accounts of the European Union on which the ECA issued an unmodified opinion.

LEGALITY AND REGULARITY OF 2010 REVENUE AND EXPENDITURE

Revenue

In the ECA's opinion, EU revenue underlying the 2010 accounts is legal and regular in all material respects.

Commitments

In the ECA's opinion, commitments underlying the 2010 accounts are legal and regular in all material respects.

Payments

Basis for adverse opinion

The ECA concludes that overall the supervisory and control systems are partially effective in ensuring the legality and regularity of payments underlying the accounts. The policy groups Agriculture and natural resources and Cohesion, energy and transport, are materially affected by error. The ECA's estimate for the most likely error rate for payments underlying the accounts is 3,7 %.

Adverse opinion

In the ECA's opinion, because of the significance of matters described in the above paragraph, the payments underlying the 2010 accounts are materially affected by error.

For the full text, please refer to the Chapter 1 of the 2010 Annual Report.

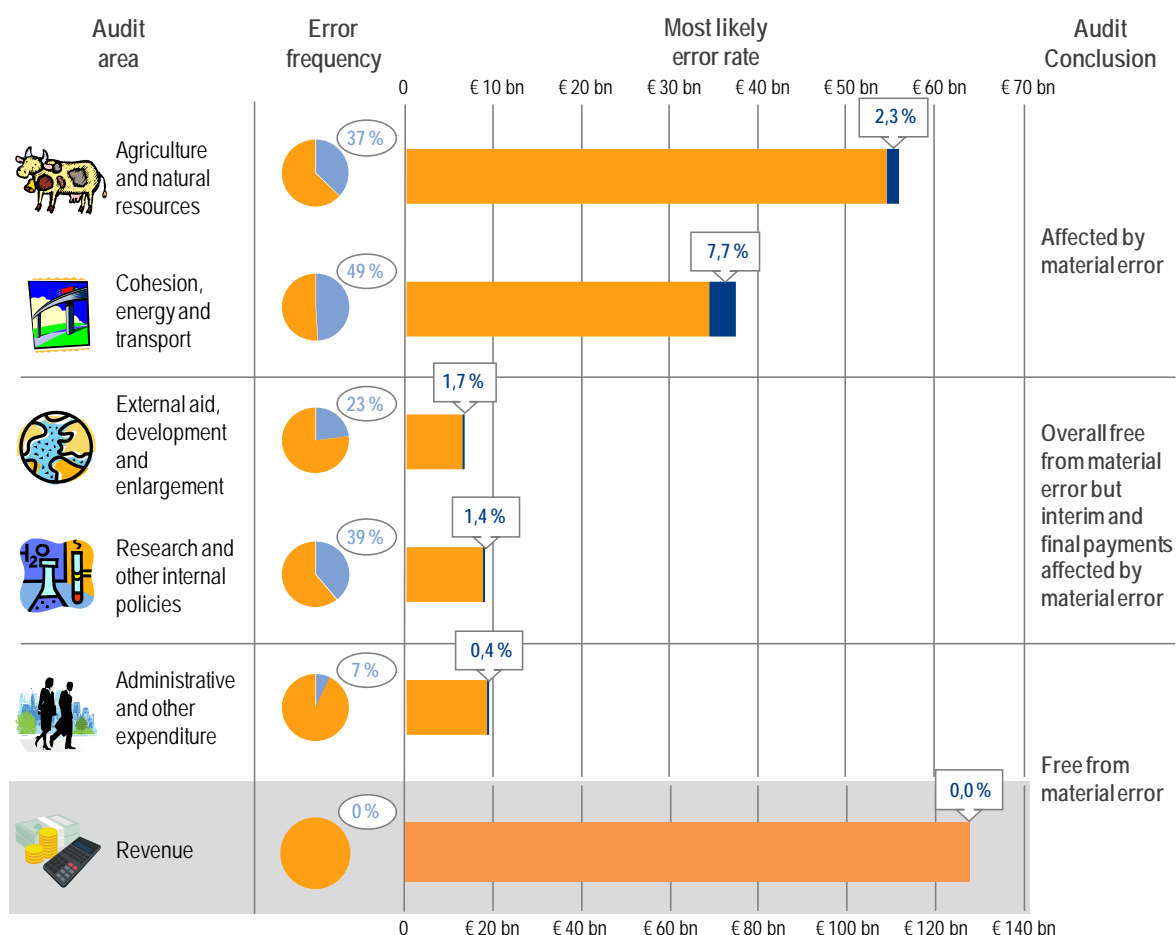
EXPLAINING THE FINDINGS

2010 is the ECA's 17th statement of assurance on the reliability of the accounts and the legality and regularity of the transactions underlying these accounts. Information on the approach used can be found in the Explanatory section of this document (page 29).

Regularity of transactions

Diagram 1 summarises the findings on the regularity of transactions identified by the testing. It shows the frequency by which transactions are affected by error, and the impact of those errors whose effects can be quantified.

Diagram 1 – Results of transaction testing



X% **Error frequency** (share of audited transactions affected by one or more error)

Y% **Most likely error rate** (weighted average of the percentage error rates found in the sample, i.e. estimated error rate)

Note: The ECA uses standard statistical techniques to estimate the error rate. For more details see Chapter 1 Annex 1.1 of the annual report.

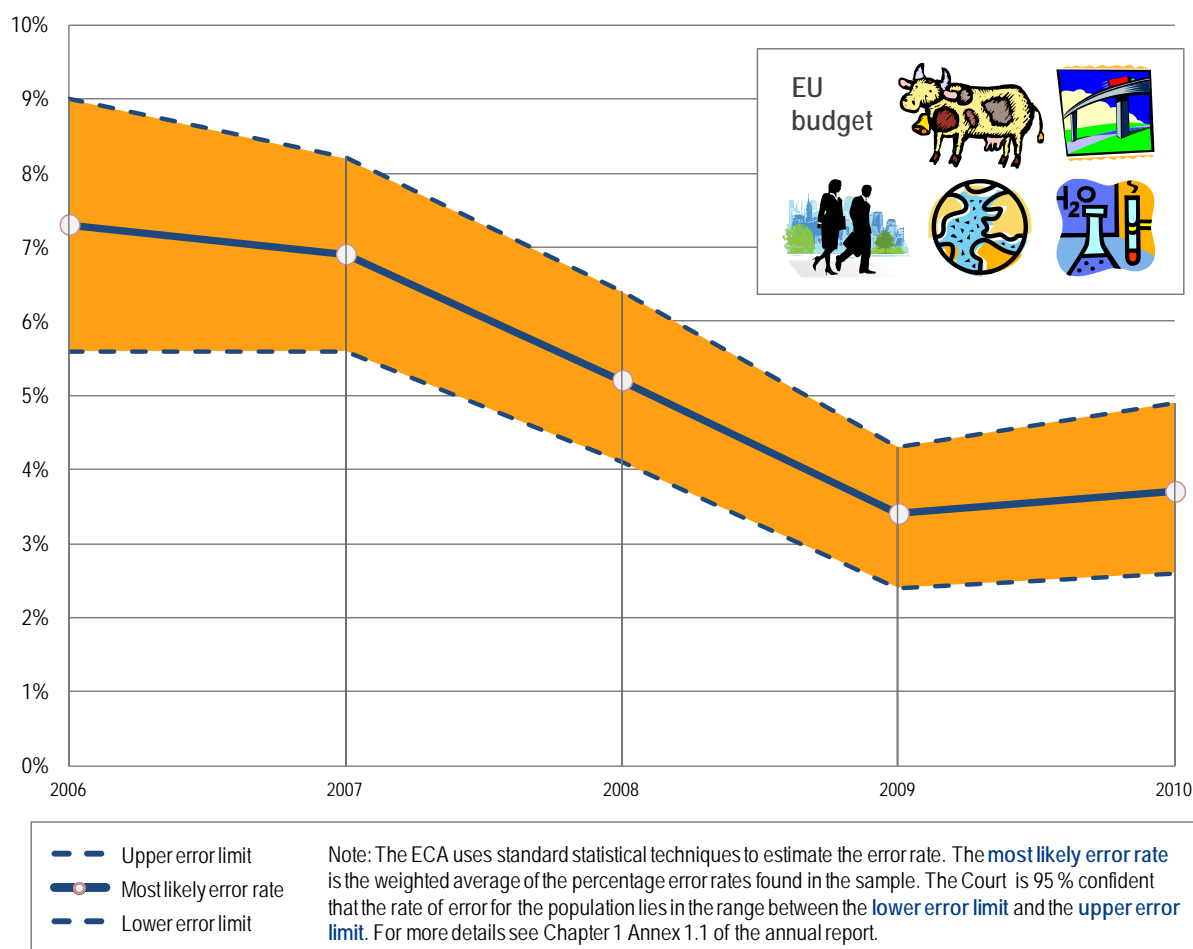
The ECA concludes that commitments in all policy groups and revenue were free from material error. For payments as a whole the estimated error rate was 3,7 % (3,3 % in 2009), resulting in an adverse opinion on the regularity of the payments underlying the accounts.

Comparison with previous years

The ECA's audit results for 2010 show an increase in its estimated error rate for the payments for the Cohesion, energy and transport policy group in comparison to the results for Cohesion of 2009.

The estimated error rate concerning the payments for the other policy groups remained relatively stable.

**Diagram 2 – Estimated error rate for the audited population of payments
2006 to 2010**



Reliability of Commission management representations

Each director-general reports on the performance of his/her duties in an **annual activity report**, accompanied by a **declaration** on the use of resources and the effectiveness of control procedures. The directors-general can issue reservations as part of their declaration, bringing attention to issues such as a high rate of error in transactions.

For the first year the Commission's **internal auditor** has provided an overall opinion on the state of Commission's internal control framework in 2010, and assessed it to be adequate. The scope of this opinion is limited to the Commission's own internal control framework. However, more than 90 % of all errors found by the ECA are identified outside the Commission at the level of beneficiaries. In other words, the control systems in place do not prevent or correct errors sufficiently to ensure that transactions taken as a whole are legal and regular.

Through its **synthesis report** of annual activity reports of directors-general, the Commission takes responsibility for the implementation of the EU budget. For 2010 it notes progress made in remedying weaknesses, including increased compliance with eligibility rules in declared expenditure, as well as areas for improvement. The ECA finds that: the scope and scale of reservations made should have been greater in several areas; data provided on recoveries is incomplete or has not been checked; and there should have been a clearer distinction between recoveries from beneficiaries and other financial corrections, whose burden falls on national taxpayers.

Increased use of pre-financing

A significant proportion of Commission payments each year is in the form of advances which pre-finance costs to be incurred at a later date. The proportion of advance payments in the EU budget has risen considerably during the current financial framework. The Commission corrected material problems concerning the completeness of pre-financing. Nonetheless, the lack of current information on the EU funds actually used by the Member States reduces significantly the usefulness of the accounting information for management. The increased use of pre-financing makes it urgent for the Commission to revisit the relevant accounting rule and to improve its supervision.

REVENUE

127,8 BILLION EURO

 Control systems were effective

 Transactions were free from material error

AUDIT AREA

The European Union's revenue finances its spending. 127,8 billion euro was raised in 2010. Own resources represent the vast majority of revenue.

The GNI and VAT-based own resources provide 71,2 % and 10,5 % of the EU budget respectively. They are calculated on the basis of value added tax (VAT) collected by Member States and Member States' gross national income (GNI). For these own resources the Commission uses macroeconomic aggregates prepared by Member States to serve as the basis for the EU revenue due. The ECA audit covers the Commission's actions in processing the macroeconomic data provided by Member States.

Traditional own resources (TOR) i.e. customs duties collected on imports and the sugar production charge that are collected by national administrations of Member States on behalf of the EU amount to 12,2 % of the EU budget.

FINDINGS AND CONCLUSIONS

Based on its audit testing, the ECA concluded that the transactions were free from material error. However, some systems weaknesses were found in transaction testing. With regard to traditional own resources it was not possible to reconcile the amount of TOR declared with the underlying records for one of the countries audited.

The ECA's audit found an error in the Commission's definitive calculation for the UK 2006 correction carried out in 2010. The amount to be deducted from the UK's own resource payments was overstated by 189 million euro, which although not material for revenue overall, represents 3,5 % of the total correction. This error has been corrected by the amendment of the 2011 budget.

The ECA found that **control systems** were in general effective in ensuring the regularity of transactions. However, as in previous years the ECA detected problems in the procedures and systems, which affect the values of suspended amounts of TOR. For VAT-based own resources, long-standing reservations still exist, but the backlog is being cleared. There are delays in monitoring of the application of the VAT directives. For GNI-based own resources some weaknesses persist and verification of GNI inventories is not yet complete.

RECOMMENDATIONS

In following up on its previous recommendations, the ECA found that while some progress had been made, further work is required in respect of the implementation of a common revision policy for the GNI-based own resources in the EU and to ensure that customs debts incurred on seized goods are booked correctly.





For 2010 the ECA recommends the Commission pursues its efforts to:

- in respect of traditional own resources, ensure the correct use and completeness of Member States' account statements, and further strengthen national customs supervision; and
- present the GNI Committee with assessment reports on Member States' GNI data in order to replace all existing general reservations with specific reservations since the 2002 financial year.



AGRICULTURE AND NATURAL RESOURCES

56,8 BILLION EURO

-  Control systems were partially effective
-  Direct payments covered by IACS control system were free from material error
-  Rural development was particularly prone to error
-  37 % of payments to beneficiaries tested were affected by error, with an estimated error rate of 2,3 %

AUDIT AREA

The majority of the direct payments of the European Agricultural Guarantee Fund (EAGF) are paid to beneficiaries based on the land area farmed. The European Agricultural Fund for Rural Development (EAFRD) co-finance projects for developing farming, rural life and environmental protection measures. The Integrated Administration and Control System (IACS) is the main control system for ensuring the regularity of both EAGF and EAFRD transactions. Farmers have to comply with a number of legal obligations in respect of land stewardship practices and environmental protection. Management of the spending is shared with Member States.

The EU's policy on the Environment, Maritime Affairs and Fisheries, Health and Consumer Protection aims to contribute to protecting and improving the quality of the environment, human health and rational utilisation of natural resources.

FINDINGS AND CONCLUSIONS

Based on its audit work the ECA concludes that for the Agriculture and natural resources policy group the **payments** tested were affected by material error. The estimated error rate is 2,3 %. However, the direct payments covered by IACS control system were free from material error representing 39,7 billion euro. Testing of rural development spending showed a higher frequency of error than in EAGF payments: 27 % of EAGF payments tested were affected by error, against 50 % of payments for rural development. The most frequent type of error was over-declaration of land by beneficiaries.

Example of errors in payments to farmers due to outdated database information

The ECA found payments to around 12 500 EAGF beneficiaries were made on the basis of outdated land area data in the LPIS, leading to an overall overpayment of 11 million euro. Contrary to EU legislation the national authorities funded the repayment to the EU budget from the national budget rather than recovering the overpayments from the farmers. This constitutes unapproved national aid.

The ECA found that the supervisory and **control systems** audited for the Agriculture and natural resources policy group were partially effective in ensuring the regularity of payments. There were weaknesses in certain paying agencies, for example in the Land Parcel Identification System (LPIS), which forms the basis for payments to farmers, and in the quality and reliability of the checks by national inspections.

Example of weaknesses in land area measurements checks national inspectors

The ECA re-performed land area measurements related to EAGF carried out by national inspectors in Bulgaria, Greece, Romania, Czech Republic and the Netherlands. The eligible areas reported by the national inspectors were found to be incorrect for 13 out of 43 parcels in Bulgaria, 6 out of 32 parcels in Greece, 12 out of 29 parcels in Romania, 35 out of 67 parcels in the Czech Republic and 16 out of 174 parcels in the Netherlands.

RECOMMENDATIONS

The Commission has taken remedial action in implementing the ECA's previous recommendations, including simplifying rural development measures and addressing the reliability and completeness of information recorded in the LPIS. However, the new Council regulation for setting EU minimum maintenance requirements for grassland, and for excluding direct aid from beneficiaries, exercising no or only marginal agricultural activity, is elective rather than compulsory leaving these issues to the discretion of Member States.





For 2010 the ECA recommends that the Commission ensures:

- the mandatory use of ortho-photos (uniform-scale aerial photos) and their update in the LPIS database of agricultural parcels;
- that the on-the-spot inspections within the control systems run by Member States are carried out properly; and
- that the quality of national inspections is adequately checked and reported on by the certification bodies.



COHESION, ENERGY AND TRANSPORT

40,6 BILLION EURO

-  Audit authorities were partially effective in ensuring the regularity of transactions
-  Cohesion continues to be the most error prone EU spending area
-  49 % of the payments audited were affected by error, with an estimated error rate of 7,7 %
-  The main sources of error were the inclusion of ineligible project costs and failures to comply with public procurement rules

AUDIT AREA

Cohesion policy aims to strengthen economic and social cohesion within the EU. Energy and transport spending supports sustainable and competitive energy and transport systems and services. EU-supported projects are undertaken by private individuals, associations, private or public undertakings or local, regional and national public bodies.

The management of the Cohesion spending, which represents more than 90 % of this policy group, is shared between the Commission and the Member States. The latter are responsible for selecting and monitoring projects, including administering and checking the payments involved. Member States make periodic declarations of the costs incurred by the project promoters to the Commission, which reimburse part of those costs (co-financing). To be eligible for reimbursement, the declared costs must comply with EU and national rules.

Energy and transport expenditure is largely implemented by the Commission.

FINDINGS AND CONCLUSIONS

Based on its audit testing, the ECA concluded that the **payments** for the Cohesion, energy and transport policy group was materially affected by error. Out of the 243 payments audited 49 % were affected by error, with an estimated error rate of 7,7 %.

For Cohesion expenditure, Member States' authorities are required to check expenditure for errors before sending it to the Commission for reimbursement. The ECA considers that the Member States' authorities had sufficient information available to have detected and corrected at least some of the errors for 58 % of the transactions affected by error.

Around 3 % of the payments audited were for wholly ineligible projects, which accounted for more than one third of the estimated error rate.

Example of a project not eligible for ERDF funding

In the case of an European Regional Development Fund project, the feasibility study forming part of the project application showed that the project was expected to generate revenue exceeding the cost of the project. This rendered the project ineligible for EU co-financing.

One fifth of transactions tested were affected by breaches of public procurement rules. Serious breaches of EU and national public procurement rules were found in 5 % of payments tested and accounted for 24 % of all quantifiable errors and almost one third of the estimated error rate.

Example of a serious failure to respect public procurement rules

Works and services related to making a river navigable for cruise ships were contracted in an irregular manner. The contracting authority apportioned the works in order to reduce the contract values below the thresholds for applying EU and national procurement rules, effectively circumventing the normal tendering requirements. Several of the contracts were awarded to the same contractor.

Declarations of various ineligible costs such as excessive costs charged to projects or lack of supporting evidence for costs claimed accounted for about one quarter of the estimated error rate.

Funds implementing Financial Engineering Instruments (FEIs) in Member States account for an increasing share of expenditure in Cohesion. At the end of 2010 FEIs had been set up with an approximate endowment value of 8,1 billion euro. Key regulatory requirements were not respected in seven out of the 13 audited payments to such funds. In addition, the Commission does not have sufficient monitoring information on the actual implementation of FEI operations at recipient level.

The ECA concluded that the **audit authorities** were partially effective in ensuring the regularity of Cohesion payments. The weaknesses found in the work of the audit authorities – a key element of Member State control arrangements - included delays in carrying out the audits and insufficient guidelines by the Commission on the scope and extent of the checks to be undertaken for the audit of projects.





RECOMMENDATIONS

The follow up of the ECA's previous recommendations shows that progress has been made: The Commission reinforced its supervision of the national management and control systems for the 2007-13 programming period, in particular through its monitoring of the work of audit authorities and increased use of interruptions and suspensions of payments. The Commission has also continued its efforts for providing guidance to national authorities implementing operational programmes (OPs) and to simplifying the eligibility rules for structural funds.

For 2010 the ECA recommends that the Commission:

- continues to monitor compliance with eligibility requirements, including the EU and national procurement rules;
- encourages national authorities to apply rigorously the corrective mechanisms prior to approving the expenditure and passing it for payment by the Commission, and continue to interrupt or suspend payments to the OPs until corrective action has been taken by the Member State;
- assesses national eligibility rules for the 2007-13 programming period to identify possible areas for simplification and potential sources of error; and
- provides further guidance for audit authorities of the Member States on sampling, the scope of verifications to be undertaken for audits of projects and the reporting of audit findings.

EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT 6,5 BILLION EURO

-  Control systems were partially effective
-  Overall free of material error, with an estimated error rate of 1,7 %
-  However, a material level of error was found in interim and final payments to beneficiaries
-  Most of the quantifiable errors concern expenditure incurred outside the eligibility period, inclusion of ineligible expenditure in the cost claims, expenditure without adequate documentary proof and payments made not covered by contracts

AUDIT AREA

Expenditure in this policy area is related to development assistance for, and economic cooperation with, countries in Asia, Latin America and African, Caribbean and Pacific (ACP) states, thematic programmes in this area, European neighbourhood policy, enlargement strategy, humanitarian aid and actions implemented under the Common Foreign and Security Policy.

The management of this policy area is implemented directly by the Commission DGs, either from their headquarters in Brussels or by the EU delegations in recipient countries, or jointly with international organisations. The spending involves the reimbursement of costs incurred through projects, and, to a lesser extent, through budget support. Development assistance for ACP states is also provided from European Development Funds.

FINDINGS AND CONCLUSIONS

Based on its audit work, the ECA concludes that taken as a whole the External aid, development and enlargement policy group was free from material error, with estimated error rate of 1,7 %. However, the interim and final payments were subject to material error.

The ECA found 23 % of **payments** to beneficiaries to be affected by error. All the quantifiable errors were found in interim and final payments, two thirds of them were found in final payments, which had not been detected by Commission controls. A high frequency of non quantifiable errors was found, including in procurement procedures and extensions of contracts.

Example of ineligible costs reimbursed in a final project payment

Several types of errors were found in a final payment to a project supporting rural families in the production and marketing of organic cashew nuts in Nicaragua representing 21,7 % of the total project costs. These included missing invoices and proofs of payments, non-compliance with procurement rules and missing certificates of origin and amounts declared not included in the accounting records. The Commission had not detected these errors at the stage of final payment.

The ECA found that the **control systems** for the External aid, development and enlargement policy group were partially effective in ensuring the regularity of payments.

RECOMMENDATIONS

The follow up of the ECA's previous recommendations shows that progress has been made, although a number of the recommendations remain to be addressed.





For 2010 the ECA recommends that:

- the Directorate General for Enlargement (1) defines in more detail the criteria for lifting ex-ante control and suspending the "conferral of management" to decentralised countries and tests the effectiveness of the systems used by national authorities; (2) develops a tool allowing the consolidation of the outcomes of monitoring visits; (3) improves the quality of data in its management information system; (4) and increases the ex-post reviews of transactions for centralised management; and
- the Commission defines a coherent methodology for the external relations directorates to calculate the residual error rate.



RESEARCH AND OTHER INTERNAL POLICIES

9,0 BILLION EURO

-  Control systems were partially effective
-  Overall free from material error, with an estimated error rate of 1,4 %
-  However, there was a significant level and frequency of errors in interim and final payments in the 6th and 7th research framework programmes
-  Principal source of error remains the incorrect calculation of personnel and indirect costs

AUDIT AREA

Research policy seeks to foster investment in research and the transition towards a knowledge-based economy. The payments are made under the 6th and 7th multiannual research framework programmes (FP6 and FP7) and are for the most part implemented by the Commission under direct centralised management. Beneficiaries may be research centres, universities, individuals, commercial firms or public administrations. They undertake projects which are eligible for EU co-financing under certain conditions. At first projects receive advance payments, with only limited conditions attached to them. The interim and final payments that follow are subject to compliance with the full range of eligibility requirements.

The Lifelong Learning Programme (LLP) aims to enable people at all stages of their lives to take part in learning experiences. It also seeks to develop the education and training sector across the EU. LLP is implemented through centralised indirect management by national agencies, who manage the numerous but small amounts of grants to teachers and students.

FINDINGS AND CONCLUSIONS

Based on its audit testing, the ECA concludes that overall the policy group Research and other Internal Policies was free from material error, with the estimated error rate of 1,4 %. However, interim and final payments for research framework programmes were subject to material error.

The ECA found that 39 % of **payments** to beneficiaries tested were affected by error: The majority (88 %) of these errors were found in interim and final payments and 95 % of the quantifiable errors concerned the reimbursement of ineligible or inaccurately declared costs to projects funded by the research framework programmes. Other sources of error include indirect taxes claimed, incorrect application of depreciation and interest generated by pre-financing.

Example of error in flat rate calculation of indirect costs

A beneficiary managing an FP6 project claimed overheads using a flat rate which was based on direct staff costs. Following an earlier ex-post audit, the beneficiary changed its allocation of overheads methodology without fully and correctly implementing the recommendations made by the ex-post auditors. Errors and inconsistencies, noted during the Court's audit led to an over-claim of 0,7 million euro.

The ECA again found that supervisory and **control systems** for Research and other Internal Policies were partially effective in ensuring the regularity of payments.

The ECA re-performed the audit of 33 cost claims at beneficiary level already certified by independent auditors as part of internal control. Errors were found in 27 of these claims, including 14 with significant financial impact. In addition, the ECA found weaknesses in the Commission's ex-ante desk checks in 47 cases of 97 research FP payments audited. These checks were often limited to arithmetical verification of the cost claim even when there was evidence that the costs declared were not eligible. ECA also found that primary controls for LLP were not fully implemented by national agencies.

Example of weakness in Commission pre-payment checks

The beneficiary of an FP6 project calculated the staff costs based on budgeted average hourly rates for three categories of staff: senior engineer, scientific graduate engineer and technician. The actual hourly rate paid to staff showed a significant divergence from that claimed for EU financing, leading to an over-claim of more than 10 % of the total declared staff costs of 0,5 million euro. Despite this information being available, the Commission did not question the declared amount in its ex-ante check.

RECOMMENDATIONS




The Commission has made efforts to implement the ECA's previous recommendations, in particular for improving control systems, including ex-post audits and recovering overpayments either directly or by off-setting against subsequent payments to the same beneficiaries.

For 2010 the ECA recommends that the Commission:

- in the area of the research FPs should: (i) further enhance its ex-ante checks in view of identifying high-risk payments, and (ii) in order to further improve the reliability of the audit certificates, raise the independent auditors' knowledge of the eligibility rules; and
- in the area of the LLP should: continue to strengthen the implementation of primary controls. The National Agencies should check the files on a regular basis and document the checks properly.

ADMINISTRATIVE AND OTHER EXPENDITURE OF THE INSTITUTIONS AND BODIES

9,3 BILLION EURO

-  Control systems were effective
-  Overall free from material error, with an estimated error rate of 0,4 %
-  Errors and weaknesses found in procurement procedures

AUDIT AREA

The biggest proportion of the Administrative and other expenditure policy group spending (63 %) relates to staff costs, such as salaries and pensions. The remainder is mostly spending on buildings, equipment, energy, communications and information technology.

The results of the ECA audits of the European Union agencies and other decentralised bodies are reported in specific annual reports, which are published separately.

FINDINGS AND CONCLUSIONS

Based on its audit testing, the ECA concludes that the **payments** for the policy group Administrative and other expenditure were on the whole free from material error. The estimated error rate was 0,4 %.

The ECA found that supervisory and **control systems** for administrative and other expenditure were effective in ensuring the regularity of payments.

However, the ECA found a number of errors and weaknesses in the implementation of procurement procedures by the EU institutions and bodies, and in one institution repeated under-utilisation of certain budget lines resulting in significant budget transfers to finance building projects. Recruitment decisions were also not always appropriately documented. These weaknesses were not material for the policy group as a whole, but were significant in the context of the individual institution or body concerned and need to be addressed by their administrations.

RECOMMENDATIONS






The ECA noted that its previous recommendation related to the calculation of staff allowances and their monitoring have been widely implemented.

For 2010, the ECA recommends the EU institutions and bodies should ensure that:

- appropriate documentation is established to justify recruitment decisions and that eligibility criteria set out in vacancy notices are respected; and
- authorising officers establish appropriate checks and benefit of better guidance in order to improve the design, coordination and performance of procurement procedures.

EUROPEAN DEVELOPMENT FUNDS (EDF)

3,2 BILLION EURO

-  EDF control systems were partially effective
-  EDF accounts and revenue were legal and regular in all material respects
-  EDF commitments were legal and regular in spite of non-quantifiable errors found in procurement
-  Material level of error found in the EDF payments to projects, with an estimated level of error of 3,4 %
-  Errors found were related to non respect of eligibility conditions

AUDIT AREA

The European Development Funds (EDF) are funded by the Member States and are subject to their own financial regulation. They are not part of the EU general budget.

The Commission implements most the expenditure in association with Africa, Caribbean and Pacific (ACP) countries through the Development and Cooperation Directorate General - EuropeAid in 2010. The investment facility part of the EDF is managed by the European Investment Bank and is not included in the ECA's audit mandate, nor in the European Parliament's discharge procedure. The EDF contribution is implemented through projects and budget support and managed either directly by the Commission, jointly with international organisations such as the UN agencies and the World Bank or in decentralised management with beneficiary countries.

FINDINGS AND CONCLUSIONS

Based on its audit testing, the ECA concludes that the **accounts** of the EDFs for the financial year 2010 fairly present the financial position and the results of the operations and cash flows. However, EuropeAid's transactional ex-post controls and the ECA's own audit again identified a high frequency of encoding errors, which, while not being material, may affect the accuracy of data in the annual accounts and the reliability of EuropeAid's management data.

The ECA concludes that the EDF **revenue** was free from material error.

The ECA also concludes that the individual EDF **commitments** tested were free from material error. However, four out of 14 individual commitments for projects tested under the decentralised management were affected by non-quantifiable errors related to tendering rules and delays in signing of contracts.

The ECA concludes that the EDF **payments** were affected by a material level of error, with 3,4 % overall estimated level of error found in its testing. 26 % of the 165 payments tested were affected by error. The majority of errors related to eligibility conditions, such as compliance with procurement procedures, undue VAT payment, expenditure incurred outside the implementation period, or ineligible activities or services.

The ECA concludes that overall the EDF **control systems** were again only partially effective in ensuring the regularity of payments.

RECOMMENDATIONS

Many of ECA's previous recommendations were addressed by the Commission, such as the launching of the Action Plan for strengthening EuropeAid's management and control pyramid end of 2010. However, weaknesses remain in certain areas.

For 2010 the ECA recommends that the Commission finalises the following actions:

- assesses the cost-effectiveness of controls and develops a key indicator for the estimated impact of error after all ex-ante and ex-post controls; and
- strengthens the effectiveness of project monitoring on the basis of multiannual plans.

EuropeAid should:

- review the reliability of the certificates of external controls;
- introduce management information systems for improved monitoring of results of on-the-spot visits, external audits and expenditure verifications and continue its efforts to improve CRIS information system;
- for budget support payments, ensure that delegations consistently apply the new format and scheme for the assessment of recipient countries' reforms of public finance management systems and promote further, through policy dialogue, the set up of clear assessment frameworks to measure progress in recipient countries' financial management reform programmes.

GETTING RESULTS FROM THE EU BUDGET

This new section of the annual report presents the ECA's observations on the Commission's self-assessment of performance in its annual activity reports and the main results of the ECA's own performance audits over the last year.

THE COMMISSION'S SELF-ASSESSMENT OF PERFORMANCE

The directorates-general establish performance objectives in their annual management plans, and report on the results achieved in their annual activity reports.

The ECA assessed the relevance, comparability and reliability of the performance information presented by the Directorates General for Agriculture and Rural Development (DG AGRI), Regional Policy (DG REGIO) and Research and Innovation (DG RTD).

The ECA observed that the differences between planned targets and the achievements were often not analysed and that the framework for reporting on effectiveness did not cover economy and efficiency of the spending. The absence of appropriate interim milestones made it difficult to assess whether the progress made could be considered on track towards the achievement of multiannual objectives.

The ECA noted that the objectives, indicators and targets set in the management plans were generally those used for reporting in the annual activity reports. Legal limitations and practical constraints impaired the reliability of the planning and reporting information collected by the directorates-general from Member States regarding programmes under shared management.

FINDINGS OF ECA PERFORMANCE AUDITS IN 2010

The 14 special reports adopted by the ECA in 2010 examine whether the EU's intervention was managed in accordance with the principle of sound financial management (economy, efficiency and effectiveness).

The special reports highlight positive examples as well as areas for improvement throughout the expenditure cycle. The findings cover the strategic planning, the identification of the needs, the adequacy of the means, the measures to avoid overspending or delays, the regular monitoring of results and the need for reporting on performance.

The ECA concludes that the quality of the planning phase is important in determining how the intended results can be obtained. Insufficient or weak planning, including the absence of SMART¹ objectives, may produce delays, additional costs, and affect the results achieved.

¹ Specific, measurable, achievable, relevant and timed.

It is important for the management's accountability that the results reported correspond to the objectives and indicators set in the management plan and that appropriate monitoring and control systems are in place to obtain reliable information for reporting on results.

The ECA recommends:

- increased focus 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;
- defining appropriate interim milestones for multiannual targets, so that progress can be assessed adequately;
- that the Commission and the Member States agree on consistent performance indicators on planned targets and achieved results, and to ensure the reliability of the information;
- that when planning EU spending programmes, the Commission and the Member States should pay greater attention to defining SMART objectives, as well as to identifying and mitigating the risks to implementation;
- accountability of 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; and
- that the Commission, together with the Members States where appropriate, should design and operate monitoring and control systems to produce complete and accurate information on results.

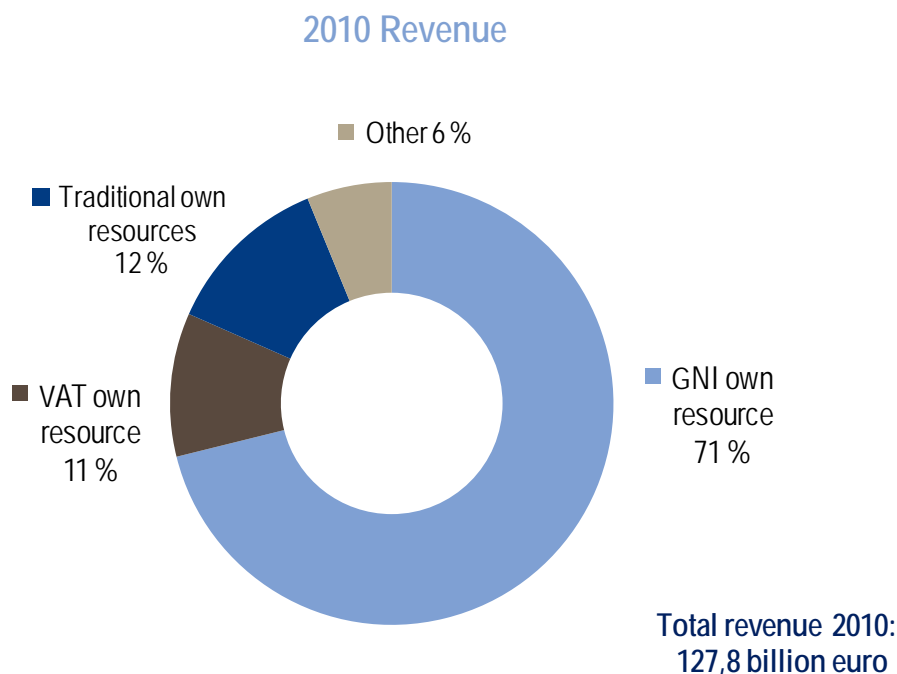
EXPLANATORY AND BACKGROUND INFORMATION

THE 2010 EU BUDGET

The EU's payments for 2010 totalled **122,2 billion euro**, equivalent to around one percent of the Union's gross national income (GNI). This can be compared with respective Member States' public sector budgets, which in many cases amount to around half of their total GNIs. The EU budget is decided annually – within the context of seven year financial frameworks – by the European Parliament and the Council. Ensuring that the budget is properly spent is primarily the responsibility of the Commission. For around 80 % of the spending – the Cohesion, energy and transport and Agriculture and natural resources policy groups – the task of implementation is shared with the EU's 27 Member States.

WHERE DOES THE MONEY COME FROM?

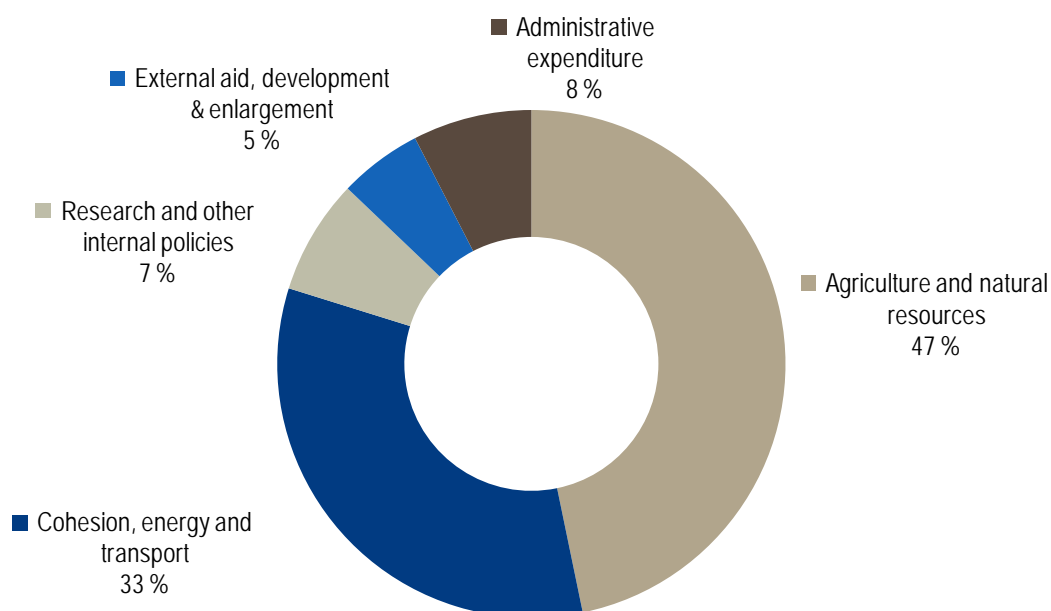
The EU revenue mainly consists of contributions from Member States based on their gross national income (GNI) and on a measurement connected to value added tax collected by the Member States (VAT). Customs and agricultural duties – Traditional own resources – also represent an important share of revenue.



WHAT IS THE MONEY SPENT ON?

The largest single share of the European Union spending is on Agriculture and natural resources – principally in the form of payments to farmers – accounting for almost half of the EU budget. Another significant proportion is spending on Cohesion (regional and social development), energy and transport co-finances a wide range of projects from renovation of a university building in Hungary to construction of railways networks across Europe. This constitutes about one third of the EU budget.

2010 Expenditure



Total payments 2010:
122,2 billion euro

DAS APPROACH AT A GLANCE

The ECA's statement of assurance opinions – *déclaration d'assurance (DAS)* - are based on objective evidence obtained in particular from audit testing in accordance with international auditing standards. This is how it is done.

RELIABILITY OF THE ACCOUNTS

Do the EU annual accounts provide complete and accurate information?

The EU budget is complex. Hundreds of thousands of accounting entries are initiated by Commission DGs each year, which capture information from many different sources (including Member States). The ECA checks that accounting processes work properly and the resulting accounting data are complete, correctly recorded and properly presented.

- Evaluation of the accounting system to ensure it provides a good basis for reliable data (complete and accurate).
- Verification of key accounting procedures to ensure they function correctly.
- Analytical checks of accounting data to ensure they are presented consistently and appear reasonable.
- Direct checking of a sample of accounting entries to ensure the underlying transaction exists and is accurately recorded.
- Check of financial statements to ensure they fairly present financial situation.

REGULARITY OF TRANSACTIONS

Do the EU income and payment transactions underlying the EU accounts comply with the rules governing them?

The EU budget involves millions of payments to beneficiaries both in the EU and the rest of the world. The majority of this spending is managed by Member States. To obtain the evidence it needs, the ECA tests payments directly and assesses the systems by which they are administered and checked.

- Samples of transactions are drawn from across the EU budget using statistical techniques to provide a basis for detailed testing by ECA auditors.
- The sample transactions are audited in detail, usually on-the-spot to obtain direct evidence that the underlying event 'exists', is properly recorded and complies with the rules under which the payments concerned are made.
- Errors are analysed and classified as either quantifiable or not.
- The impact of errors is calculated through the extrapolation of quantifiable errors in the form of a 'most likely' error rate.
- The quality of a sample of control systems is assessed to determine their effectiveness in making sure the transactions they manage are legal and regular.
- Other relevant information is taken into account, such as Annual activity reports and reports of other auditors.
- All findings are discussed with both the national authorities and the Commission to ensure the facts are correct.
- The ECA adopts its opinions based on the work done and results achieved.

Note: this provides only an outline of the complex audit process. More information can be found in Annex 1.1 of the 2010 Annual Report.



THE ECA AND ITS WORK

The European Court of Auditors - ECA - is the independent **audit institution** of the European Union. We are based in Luxembourg and employ around 900 professional and support staff of all EU nationalities. Since the creation of the ECA in 1977 we have focused attention on the importance of EU financial management and contributed to its improvement.

The ECA's audit reports and opinions are an essential element of the **EU accountability chain**. Our output is used to hold to account those responsible for managing the EU budget. This is mainly the Commission, but also the other EU institutions and bodies. Member States also play a major role in shared management.

OUR PRINCIPAL TASKS ARE:

- **financial and compliance audits**, principally in the form of the statement of assurance (or DAS);
- **performance audits** of topics selected to maximise the impact of our work; and
- **opinions** on regulations related to budgetary management and other issues of importance.

We aim to manage our **resources** in a way that ensures an appropriate balance between our various activities, helping achieve robust results and a good coverage across the different areas of the EU budget.

OUR OUTPUT

We produce:

- **annual reports** on the general budget and European Development Funds. The annual reports mainly comprise the DAS opinions and results, and are published each year in November;
- **specific annual reports** setting out the ECA's financial audit opinions on each of the EU's various agencies and bodies. 37 published for 2010;
- **special reports** on selected audit topics, published throughout the year. They are mainly performance audits. Around 16 will be published in 2011;
- **opinions** used by the European Parliament and the Council when drafting and approving rules and regulations with a financial management impact. 4 published in 2011;
- **annual activity report** providing information and insight on our activities for the year.

Our work contributes to raising awareness and increasing transparency about EU financial management, providing assurance on the state of that management and making recommendations for further improvement. We do so in the interests of the **citizens of the European Union**.

For more information on our role and work please see our website www.eca.europa.eu or contact eca-info@eca.europa.eu.



ECA POLICY GROUPS
LISTS OF CORRESPONDING SECTIONS (S)
AND TITLES (T) OF THE 2010 BUDGET

AGRICULTURE AND RURAL DEVELOPMENT

- T 05 - Agriculture and rural development
- T 07 - Environment
- T 11 - Maritime affairs and fisheries
- T 17 - Health and consumer protection

COHESION, ENERGY AND TRANSPORT

- T 04 - Employment and social affairs
- T 06 - Energy and transport
- T 13 - Regional policy

EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

- T 19 - External relations
- T 21 - Development relations with African Caribbean and Pacific (ACP) countries
- T 22 - Enlargement
- T 23 - Humanitarian aid

RESEARCH AND OTHER INTERNAL POLICIES

- T 01 - Economic and financial affairs
- T 02 - Enterprise
- T 03 - Competition
- T 08 - Research
- T 09 - Information society and media
- T 10 - Direct research
- T 12 - Internal market
- T 15 - Education and culture
- T 16 - Communication
- T 18 - Area of freedom, security and justice
- T 20 - Trade

ADMINISTRATIVE AND OTHER EXPENDITURE

- T 14 - Taxation and customs union
- T 24 - Fight against fraud
- T 25 - Commission's policy coordination and legal advice
- T 26 - Commission's administration
- T 27 - Budget
- T 29 - Statistics
- SI - Parliament
- SII - Council
- SIII - Commission
- SIV - Court of Justice
- SV - Court of Auditors
- SVI - Economic and Social Committee
- SVII - Committee of the Regions
- SVIII - European Ombudsman
- SIX - European Data-Protection Supervisor

THE EUROPEAN COURT OF AUDITORS IS THE INDEPENDENT EXTERNAL AUDIT INSTITUTION OF THE EU

Every year in its annual reports the ECA gives an opinion - or statement of assurance - on the reliability of the accounts and the legality and regularity of the transactions underlying them. The purpose of this information note is to give a summary. The full texts of the annual reports, as adopted by the ECA, are available on its website and are published in the Official Journal of the European Union.



FOR MORE INFORMATION

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