

Special Report

**Errors in rural  
development spending:  
what are the causes,  
and how are they being  
addressed?**



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Luxembourg: Publications Office of the European Union, 2015

ISBN 978-92-872-1654-0  
doi:10.2865/92113

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*Printed in Luxembourg*

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(pursuant to Article 287(4), second subparagraph, TFEU)

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**Administrative checks:** Formalised, automated checks carried out by the paying agencies on all applications in order to verify that they comply with the terms under which aid is granted. All elements that it is possible and appropriate to control by administrative means should be verified.

**Agricultural activity:** Production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, or maintaining the land in good agricultural and environmental condition.

**Area-related aid:** Support granted for the sustainable use of agricultural land. The aid is paid per each eligible hectare declared.

**Deadweight:** A situation where a subsidised operation would have been wholly or partly undertaken even without public aid.

**Eligibility criteria:** Rules that need to be respected otherwise the support claimed shall not be paid or shall be withdrawn. These rules should target limited financial resources in order to achieve the objectives of the programme.

**Error rate:** The error rate for each irregular transaction is the ratio of the error amount to the total amount paid. The calculation of the overall error rate is explained in **Box 1**.

**Farming commitment:** Farming practices that the applicant undertakes to respect.

**Gold-plating:** Unnecessary and/or disproportionate rules, such as excessive eligibility conditions.

**Investment measure:** Support granted for tangible or intangible investments.

**Irregularity:** Any infringement of a provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure<sup>1</sup>.

**Managing authority:** A national or regional body designated by the Member State to manage a Rural Development Programme (RDP).

1 Article 1(2) of Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests (OJ L 312, 23.12.1995, p. 1).

## Glossary

**Measure:** An aid scheme for implementing a policy. Each measure sets out specific rules to be complied with by the projects or actions that can be financed. There are two main types of measures: investment measures and area-related aid.

**On-the-spot checks:** Verifications carried out by the paying agency's inspectors in order to check compliance with the applicable rules, including a visit to the applicant's premises (e.g. on-farm inspections to measure and assess the eligibility of the parcels declared). Certain elements, such as the existence of animals, can only be checked on the spot.

**Paying agency:** The body responsible within a Member State for the proper assessment, calculation, inspection and payment of agricultural subsidies. Part of the work of the paying agency may be done by delegated bodies.

**Public procurement:** Tender process to be followed by public bodies when purchasing goods, works and services above a certain threshold. The aim is to obtain the best value offer by creating sufficient competition between suppliers and to ensure that contracts are awarded fairly, transparently and without discrimination. Directive 2004/18/EC and Directive 2004/17/EC set out the legal framework for public procurement which needs to be implemented by the national authorities.

**Rural development programme:** A document prepared by a Member State or region, and approved by the Commission, to plan and monitor the implementation of the rural development policy. It may contain up to 46 different measures and additional sub measures.

**Shared management:** Method of implementation of the EU budget where implementation tasks are delegated to the Member States<sup>2</sup>. To that end, Member States authorities designate bodies responsible for the management and control of EU funds. Such bodies report to the Commission. In the context of the present report, these bodies are the 'paying agencies'.

**Small and medium-sized enterprises (SMEs):** Enterprises employing less than 250 people and having an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro<sup>3</sup>.

- 2 Article 59 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 (OJ L 298, 26.10.2012, p. 1).
- 3 Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36).

## I

The European Union (EU) and Member States allocated more than 150 billion euro to rural development policy during the 2007–13 programming period. Implemented under shared management, the total budget was almost equally divided between investment measures (mainly supporting investments in tangible and intangible assets) and area-related aid (compensating farmers for their efforts in carrying out certain farming activities).

## II

The Court estimates that the average error rate for rural development expenditure incurred during the past 3 years was 8,2 %<sup>4</sup>. Investment measures accounted for two thirds of this error rate, and area-related aid accounted for one third. In this context, this special report aims to describe the main causes of this high error rate and to assess whether the steps taken by the Member States and the Commission will address the identified causes effectively in future.

## III

The Court concludes that the Commission and the Member States are partially effective in addressing the main causes of the high error rate for rural development. This overall conclusion is mainly based on the assessment that, despite the Commission's initiatives, Member States' action plans did not systematically address the weaknesses identified.

## IV

The causes of errors were identified by analysing the sample of 461 payments selected randomly during the audits of legality and regularity for 2011, 2012 and 2013. Knowledge stemming from the Court's assessment of the control systems operating in the Member States complemented this first step of the work. In a second step, the Court reviewed the action plans for 10 out of the 27 Member States, and examined whether they effectively identified the causes of errors and included remedial action. This work was completed by assessing the potential impact of the EU legal framework for the 2014–20 programming period on the causes of errors.

## V

Non-compliance with public procurement rules contributed to one eighth of the error rate. The main infringements were unjustified direct award without a competitive procedure, misapplication of selection and award criteria or lack of equal treatment of tenderers. Lack of knowledge in applying procurement rules and the preference for working with certain suppliers are the main explanations for these situations.

## VI

Unintentional breaches of eligibility criteria by public and private beneficiaries accounted for a quarter of the error rate. Suspected intentional infringements by private beneficiaries contributed to another eighth of the error rate. The Court found that the measure supporting the processing of agricultural products was the most prone to error, while the measure supporting the initial setting up of young farmers was not affected by eligibility errors.

<sup>4</sup> The most likely error rate reported for the entire policy group (rural development, environment, fisheries and health) was 7,7 % for the 2011 financial year, 7,9 % for 2012 and 6,7 % for 2013. The error rate for rural development alone is higher than for the other components of the group (for the corresponding figures relating to Rural Development only see also footnote 5 of paragraph 4).



### VII

Member States' control authorities could and should have detected and corrected most of the errors affecting investment measures (those made both by private and public beneficiaries). Control systems are deficient because checks are not exhaustive and are based on insufficient information.

### VIII

Area-related aid generated almost a third of the error rate, the main cause being non-compliance with farming commitments. There are three explanations for this situation: low incentives for farmers to comply, a low control rate for commitments and a low sanction rate for non-compliance. On the other hand, compensatory payments for less-favoured areas, with similar characteristics as the measure supporting the setting-up of young farmers, are less affected by error.

### IX

The action plan exercise initiated by the Commission is a step in the right direction in addressing the causes of error. However, action plans implemented by Member States mainly have a reactive role, and do not systematically address the problems that caused the errors in all the Member States. Moreover, there is a lack of preventive action against widespread weaknesses at EU level. The EU legal framework for the 2014–20 programming period is a potential means of addressing the causes of error. However, two stages in the regulatory set-up which are currently ongoing provide the main potential for reducing errors: the Commission's review and approval of rural development programmes, and the Member States' implementation of national regulatory frameworks.

### X

In the context of addressing the causes of error, a recurring finding in this report has been the need to maintain an appropriate balance between the number and complexity of rules, as a transposition of the need to achieve pre-defined objectives, and the need to guarantee the legality and regularity of spending. In the Court's opinion, finding the right balance between these two counterweights is the key to the successful implementation of the rural development policy.

### XI

The Court makes the following recommendations:

- (a) The Commission should complete its corrective actions to date by continuing to focus on the root causes of error for rural development spending. In this regard, preventive and corrective actions should be taken by the Member States where relevant concerning: public procurement, intentional circumvention of rules and agri-environment payments.
- (b) The Commission should closely monitor the implementation of RDPs and in its conformity audits take account of the applicable rules including those adopted at national level where relevant, in order to reduce the risk of repeating weaknesses and errors encountered during the 2007–13 programming period.
- (c) The Commission and the Member States should analyse:
  - (i) to what extent the characteristics of a more focused scope, limited eligibility criteria and the use of simplified cost options can be replicated into the design and implementation of an increased number of support measures, without jeopardising the overall objectives of those measures;

- (ii) how to improve the scheme for supporting investments in the processing of agricultural products, taking into consideration the following elements:
  - the actual need for public aid for this sector and the risk of deadweight;
  - the categories of beneficiaries targeted: farmers looking to achieve vertical integration of their business, or companies which have no agricultural activity;
  - the high public aid ceiling, which constitutes an incentive for large corporations, as only they have access to the required co-financing;
  - the entire set of eligibility conditions and the potential for circumventing them;
  - greater efforts to improve the design and performance of administrative and on-the-spot controls.
- (iii) the agri-environment payments measure so that, as far as possible, commitments can be controlled via Member States' administrative checks.

## 01

The European Union (EU) allocated almost 100 billion euro to achieving rural development objectives during the 2007–13 programming period. Member States also allocated 55 billion euro of their own resources to co-finance the EU's rural development policy. This public support is implemented under 'shared management' arrangements (see **Figure 1**).

## 02

Member States allocated around half of the rural development budget to support *investment measures*. Examples of such measures are the modernisation of agricultural holdings, setting up of young farmers or improving basic services for the rural population. *Area-related aid* received the other half of the funding. The largest measures under this type of aid are agri-environment payments and compensatory payments to farmers in areas with natural handicaps, such as mountain areas. The **Annex** of this report lists all measures and their financial execution.

## 03

The Court's Annual Reports published since 2011 have included specific assessments of the 'rural development, environment, fisheries and health' policy group, of which rural development spending represents around 90 %. This assessment is based on the results of the Court's testing of the legality and regularity of transactions and the effectiveness of control systems.

## 04

For rural development alone, the Court estimates the average error rate for expenditure incurred during the past 3 years was 8,2 % based on a representative sample of transactions (see also paragraph 8)<sup>5</sup>. **Box 1** shows how the cases of non-compliance identified for the individual transactions are quantified for the purposes of calculating the error rate.

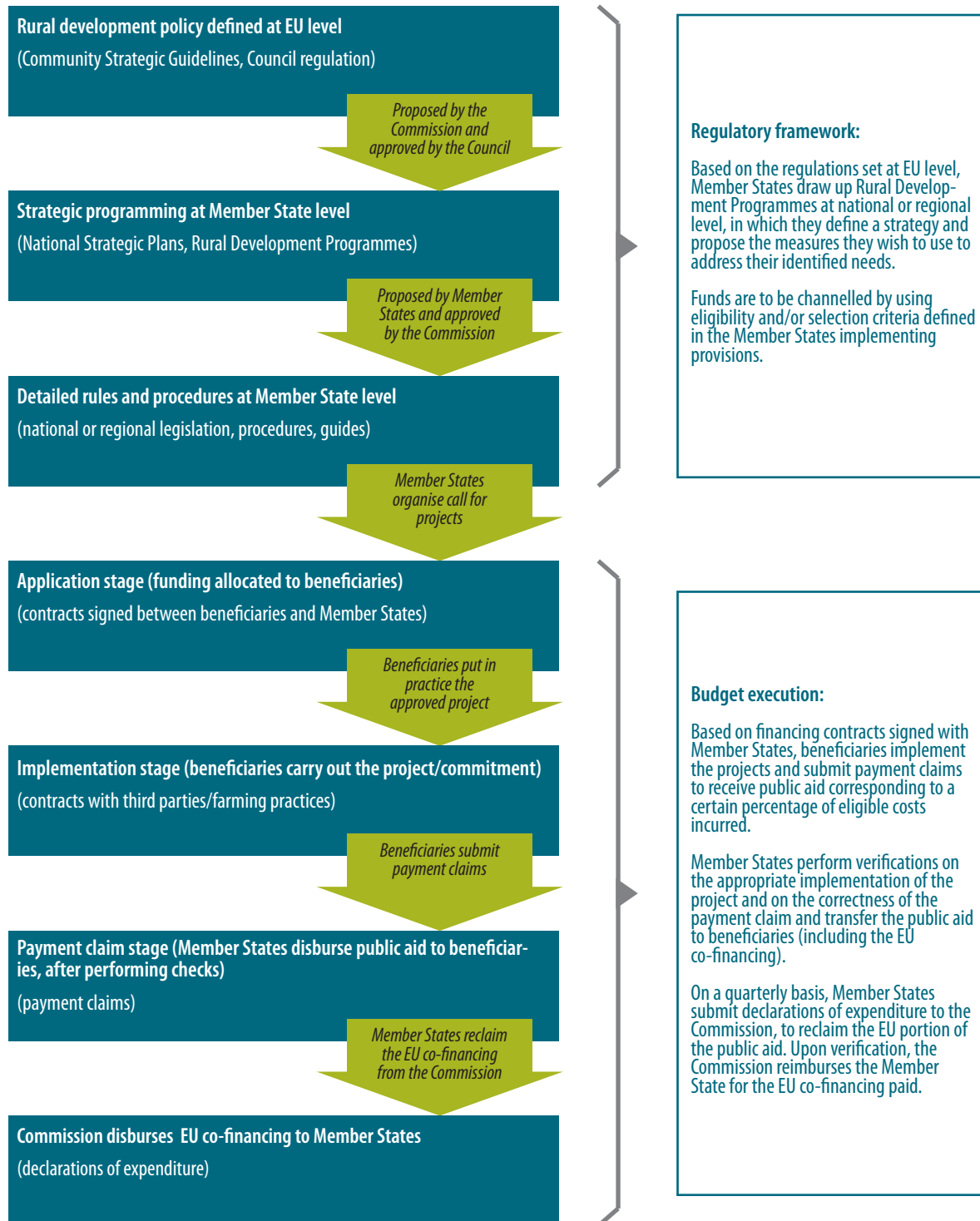
## 05

The significant level of non-compliance with applicable rules, as reflected by the high error rate<sup>6</sup>, means that the money concerned is not spent according to the rules. This may negatively affect the attainment of rural development policy objectives (improving the competitiveness of agriculture and forestry; improving the environment and the countryside; improving the quality of life in rural areas and encouraging the diversification of economic activity).

- 5 The 8,2 % is an average for the 3 years with a lower limit of 6,1 % and an upper limit of 10,3 %. The average is composed of 8,4 % for 2011, 8,3 % for 2012 and 7,9 % for 2013.
- 6 The Court's materiality threshold is 2 % of audited expenditure. This means that, in the auditors' judgement, total errors below this threshold are unlikely to be material; in other words, they are not likely to influence users of the financial information.

Figure 1

**Implementation of the EU’s rural development policy under shared management**



### Calculation of the error rate

The Court defines as errors those transactions (or parts thereof) which were not in accordance with the purposes approved by the budget and the legal basis, not correctly calculated and/or not in compliance with the relevant rules and regulations.

To assess whether an error has occurred, the Court aims to answer the following question: 'Would the amount paid, or the contractor selected, have been different if the applicable procedures had been followed correctly?'

If the reply to the question above is 'yes', and if it is possible to measure how much of the amount audited was affected by error, then the monetary value of the error is calculated as follows.

- For investment measures, the error amount represents the value of the cost item that is deemed ineligible.
- For public procurement, failures to observe the procedural requirements of procurement law, that obstruct the objectives of fair competition and award of the contract to the best qualified bidder, are considered to affect the entire value of the payment related to the contract.
- For area-related aid, the reduction system applied by the Member State is used to quantify the breaches of specific commitments applicable to the farmer<sup>7</sup>. The error amount also includes discrepancies in the areas of agricultural parcels, revealed by measurements carried out with GPS devices.

The error rate for each irregular transaction is the ratio of the error amount to the total amount paid. These error rates are then extrapolated to the amount of the entire population audited.

---

<sup>7</sup> EU legislation requires Member States to apply reductions where beneficiaries over-claim the actual area or number of animals, or do not respect commitments.

## 06

This report describes the main causes of the high error rate for rural development. It also assesses whether the steps taken by the Member States and the Commission are likely to address the identified causes effectively in future. The report includes information made available to the auditors up to the end of September 2014, when the audit work was completed.

## 07

The overall audit question was:

### **To what extent are the main causes of the high error rate for rural development being effectively addressed by the Commission and the Member States?**

The detailed questions which the audit aimed to answer were:

- What are the main causes of the error rate in investment measures?
- What are the main causes of the error rate in area-related aid?
- Do the Member States' action plans and the new EU legal framework have the potential to address these causes effectively?

## 08

To reply to the first two sub-questions, the Court analysed the results reported for the sample of transactions selected randomly during the audits of legality and regularity for 2011, 2012 and 2013. Taking the results of 3 years instead of one allows for a more detailed analysis of the types of error. The analysis included reviewing 461<sup>8</sup> transactions, of which 160 had an impact on the error rate. This identification of the causes of errors was complemented by knowledge stemming from the Court's examination of the control systems operating in the Member States between 2011 and 2013.

## 09

In its reply to the 2012 Annual Report, the Commission indicated that extensive action plans had been implemented for each of the 27 Member States to identify the causes of errors and to develop appropriate remedial action. The Court selected 10 of these action plans<sup>9</sup> and investigated whether they targeted the weaknesses identified by the Court, the Commission and the Member States themselves. This exercise, which built partially on the work performed for the annual report, also involved interviews with the Commission's desk officers for the Member States concerned.

- 8 Of the 482 transactions referred to in the Annual Reports for 2011, 2012 and 2013, 21 transactions were excluded because they represented payments for the closure of previous programming periods, or payments under the pre-accession assistance programme.
- 9 Bulgaria, Denmark, Germany — Berlin-Brandenburg, Spain, France, Italy — Lombardy, Latvia, Hungary, Portugal and Romania.

## Audit scope and approach

### 10

At the date of adoption of this report, the EU regulations for the new 2014–20 rural development programming period had already been approved. This allowed the auditors to consider the extent to which the changes introduced by the new legal framework were likely to have a significant impact on the causes of errors. The Member States' regulatory frameworks for the new programming period were still in the drafting stage and therefore did not fall under the scope of this report.

### 11

This report focuses on the compliance of rural development implementation with the applicable laws and regulations, and only makes marginal references to performance aspects — economy, effectiveness and efficiency. These elements of sound financial management are extensively covered by other special reports of the Court.

# Types and prevalence of errors found

## Overall

### 12

This section contains an analysis of the sample of 461 payments examined, and of the 160 on which the average error rate of 8,2 % is based.

### 13

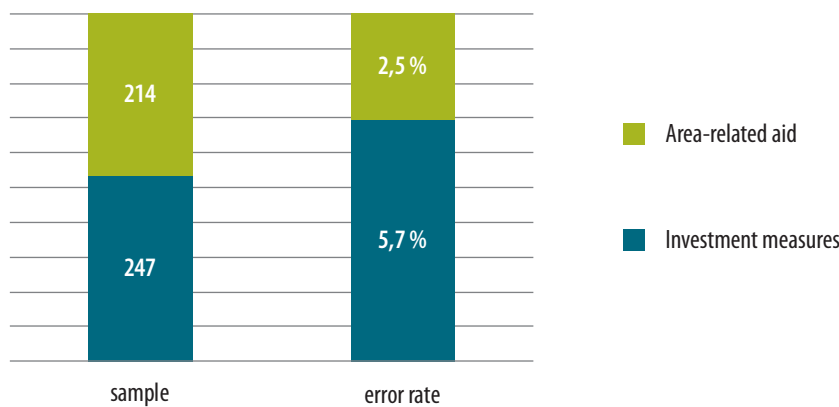
**Figure 2** shows that the sample was almost equally split between the two main types of measures. It also shows that investment measures accounted for a greater proportion of the error rate (around two thirds) than area-related aid (around one third).

### 14

As **Figure 1** shows, the regulatory framework comprises two layers: the EU level, which sets general requirements and conditions, and the Member State level. Member States implement the requirements of EU regulations and establish additional conditions according to their own policy objectives. Regarding the type of legislation breached, the Court found that only 1,3 percentage points of the error rate were due to non-compliance with direct provisions of EU regulations. Most of the error rate (6,9 percentage points) was due to breaches of conditions set at Member State level.

Figure 2

Share of area-related aid and investment measures in the sample and the error rate





## Types and prevalence of errors found

### Investment measures

#### 15

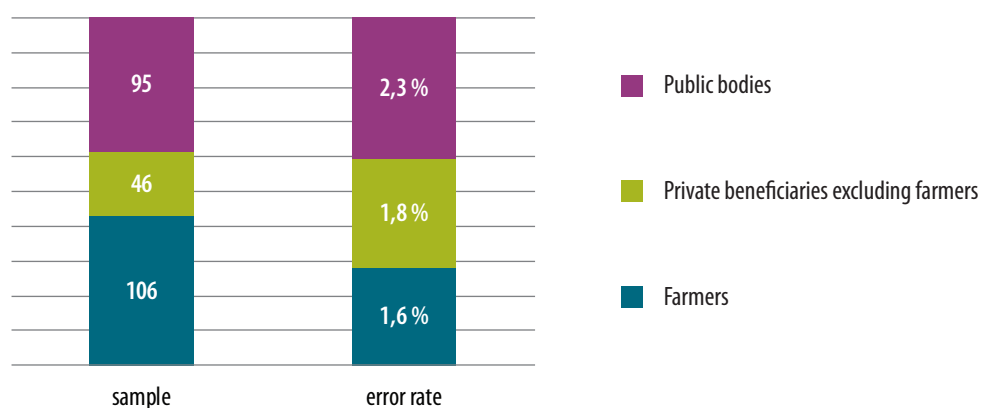
**Figure 3** presents a breakdown of the different types of beneficiaries for investment measures. It shows that public bodies caused a quarter of the 8,2 % error rate. There are two main categories of private beneficiary: farmers and those without agricultural activity. The latter represented a fifth of the sample, but contributed to a third of the error rate for investment projects.

#### 16

For investment measures, the most common errors found were breaches of eligibility conditions, indications that private beneficiaries may have committed intentional irregularities, and failures to comply with public and private procurement rules (see **Figure 4**). Investment projects typically consist of a small number of individual high-value cost items. This means that when individual cost items are deemed to be ineligible, they result in a relatively high error rate as a proportion of the total payment. Also, if projects or beneficiaries are ineligible, this results in a 100 % error rate being applied to the audited payment.

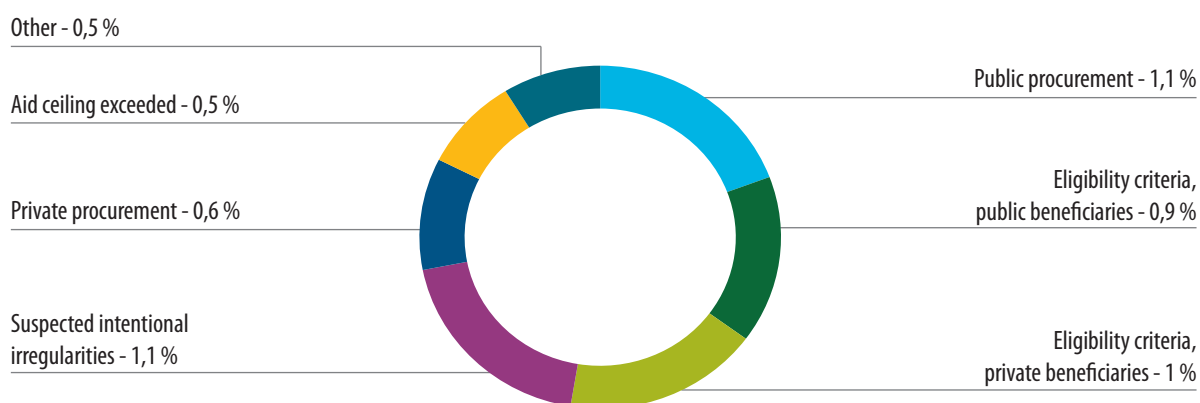
Figure 3

### Share of different types of investment beneficiaries in the sample and the error rate



## Types and prevalence of errors found

**Figure 4 Breakdown of the 5,7 % contribution to the error rate by investment measures**



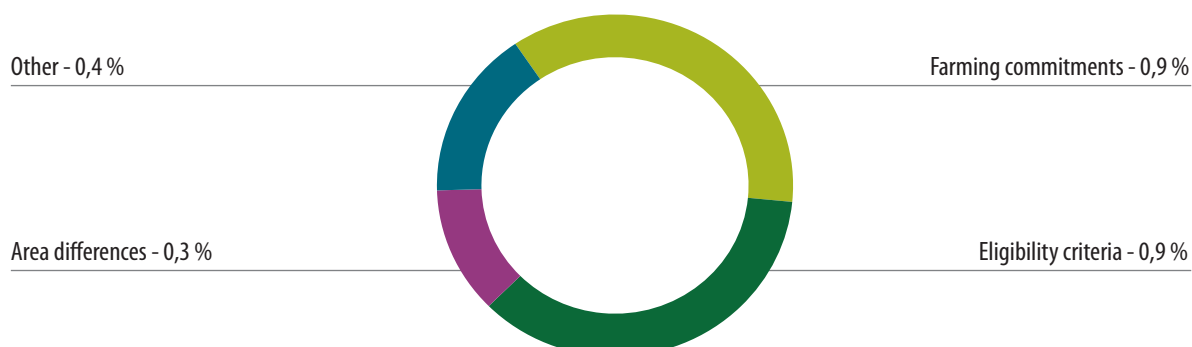
### Area-related aid

#### 17

For area payments, most of the irregularities found involved non-compliance with agri-environment commitments (obligations concerning land or farm management), ineligible agricultural

parcels and over declarations (see **Figure 5**). Errors generally concern a limited area of the farm, resulting in a smaller error rate per payment, as opposed to investment measures, where eligibility breaches affect a higher portion of the payment.

**Figure 5 Breakdown of the 2,5 % contribution to the error rate by area-related aid**



## Types and prevalence of errors found

### Differences in the financial implementation rate and the error rate between groups of Member States

#### 18

The rural development budget for the period 2007–13 (see paragraph 1) is broken down by Member States on an annual basis. Council Regulation (EC) No 1290/2005<sup>10</sup> requires the Commission to decommit any portion of an annual commitment which has not been used within a period of 2 years after the year of the commitment (known as the 'n+2 rule'). This rule aims to speed up the implementation of programmes.

#### 19

The Court has compared the Member States' financial implementation rates (i.e. the ratio of cumulative actual payments to plan) with their error rates. In order to obtain statistically representative information, the 27 Member States which had 2007–13 rural development programmes were divided into three groups of nine Member States in descending order of their financial execution rates as at 15 October 2013. The information available does not enable showing results on individual Member States. The following Member States are represented in the three groups.

- Highest financial execution rate: Belgium, Czech Republic, Estonia, Ireland, Latvia, Luxembourg, Austria, Slovakia and Finland.

- Medium financial execution rate: Germany, France, Lithuania, the Netherlands, Poland, Portugal, Slovenia, Sweden and the United Kingdom.

- Lowest financial execution rate: Bulgaria, Denmark, Greece, Spain, Italy, Cyprus, Hungary, Malta and Romania.

#### 20

**Figure 6** presents aggregated figures since the beginning of the programming period (2007) until the end of the 2013 financial year<sup>11</sup>; they show a strong negative correlation between financial implementation rates and error rates for the three groups of Member States. The same analysis was carried out for different dates, and separately for investment measures and area-related aid, with similar results. However, area-related aid is mostly based on multiannual contracts, resulting in relatively stable implementation and error rates. The correlation is more pronounced for investment measures, for which implementation rates are lower and error rates are higher.

#### 21

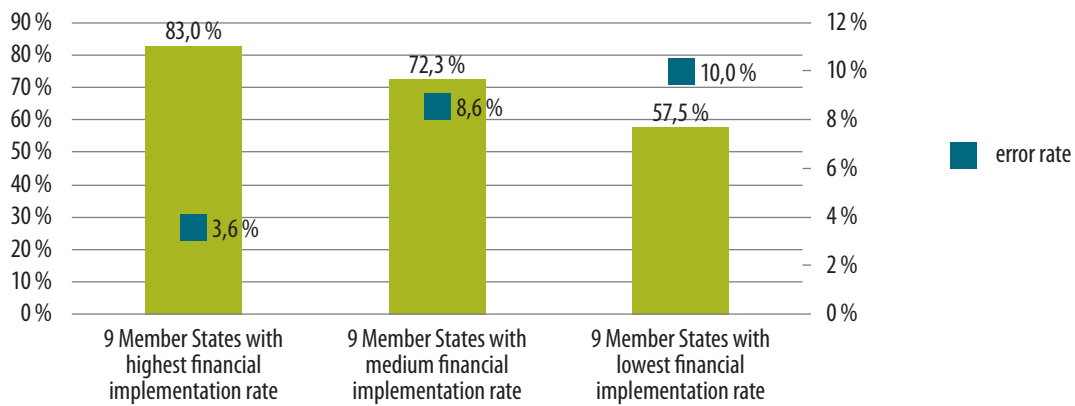
A detailed analysis of the correlation between the financial execution rate and the error rate was not part of the scope of this audit.

10 Article 29 of Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.08.2005, p. 1).

11 Member States declare their rural development expenditure paid out in the period 1 July–15 October to the Commission by 10 November. Once accepted, the EU contribution is paid in December. As such, 15 October 2013 represents the last expenditure subject to this audit.

Figure 6

Comparison of financial implementation rates with error rates for three groups of nine Member States



## **PART I** **What are the main causes of the error rate in investment measures?**

### **22**

This section examines the causes of errors in investment measures, which contributed to two thirds of the error rate (see **Figure 2**). The Court found the main drivers of the error rate to be the type of beneficiary and the type of measure. Some measures were more prone to error, whereas others were hardly affected by error.

**Public bodies are a significant source of error because of non-compliance with public procurement rules**

### **23**

The main objectives of aid provided to public bodies for rural development measures are to improve the quality of life in rural areas, to improve and develop agricultural infrastructure, and to restore forestry potential. Measures supporting these objectives represented around a quarter of total investment expenditure. In addition, up to 4 % of the total rural development budget may be used by managing authorities as 'technical assistance' to finance preparation, management, monitoring, evaluation, information and control activities carried out under rural development programmes.

### **24**

Most of the audited public bodies were municipalities or associations thereof. The Court also audited central, regional and local governments (including paying agencies), as well as other public organisations such as irrigation consortia.

### **25**

Directive 2004/18/EC<sup>12</sup> requires Member States to oblige public bodies to conduct competitive public procurement procedures when awarding contracts. It states that exceptions are only permitted in justified circumstances (e.g. for reasons of extreme urgency brought about by unforeseeable events). Commission Regulation (EU) No 65/2011<sup>13</sup> stipulates that investment projects must comply with applicable national public procurement rules.

### **26**

Errors in public procurement procedures account for one eighth of the average error rate for rural development. This figure only includes instances where serious breaches of the public procurement rules influenced the selection of the successful tenderer.

- 12 Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (OJ L 134, 30.4.2004, p. 114).
- 13 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).

27

Of the many applicable rules, only three categories of the serious breaches of procurement rules led to this significant impact on the error rate (see **Table 1**).

28

The Court found two main reasons that could explain the breaches in public procurement rules. Firstly, rural infrastructure projects are commonly implemented by small municipalities which often have limited experience of conducting public procurement procedures, and do not have trained and experienced staff at their disposal. During the tendering procedure, the national authorities do not provide detailed guidance.

Table 1

Breach of public procurement rule	Example
Unjustified direct award without a competitive procedure	The beneficiary of an investment project, a municipality in the Netherlands, agreed to conduct a tendering procedure and delegated implementation of the project to a foundation. The agreement with the foundation set out the procurement procedure, specifying that a competitive procedure should be applied which should be published on a dedicated website. However, 3 weeks after signing the agreement, the board of the foundation decided to apply a direct award procedure, without publishing this on the dedicated website.
Misapplication of selection and award criteria	In Germany (Brandenburg-Berlin), a municipality organised a competitive procedure to select a broadband Internet supplier. During the evaluation of the offers, the municipality used award criteria other than those published in the tender notice, followed by a negotiated procedure in which only two of the bidders were allowed to participate. At the end of the procedure, the municipality did not choose the most economical offer.
Lack of equal treatment of tenderers	In Romania, a rural municipality obtained support for an investment project which included a water supply network, a sewage system, improvement of local roads and a community centre. Seven tenderers submitted offers for the public works contract; the beneficiary rejected five of these on the grounds that they did not fulfil the requirements. The Court found that the winning tenderer had also failed to fulfil two requirements which had been used as grounds for rejecting other bids.

## 29

Secondly, errors are also caused by certain beneficiaries preferring to work with specific contractors, and therefore awarding contracts directly without publishing a contract notice or asking for offers from any other potential bidders. In 80 % of these cases, the successful bidder was one which had previously provided similar goods or services to the beneficiary (see **Box 2**). The paying agencies did not object to this on any occasion, even though the basic procurement principles of transparency, objectivity, non-discrimination and appropriate disclosure had not been fulfilled.

### Box 2

#### Contracts awarded directly to existing suppliers

In Sweden, a regional government body implemented a project under the measure 'Infrastructure related to the development and adaptation of agriculture and forestry'. The audited project was a continuation of a previous project.

Swedish public procurement law allows contracts to be directly awarded only in exceptional circumstances, or if the value of the contract is below a certain threshold, in which case the contracting authority must obtain at least three bids.

The beneficiary did not respect these rules and awarded three contracts directly, after having obtained only one offer in each case, namely from the companies which had provided the same services for the previous project.

#### Beneficiaries' non-compliance with eligibility criteria had a significant impact on the error rate

## 30

The Council regulation on support for rural development<sup>14</sup> stipulates that expenditure is eligible only if it has been incurred in accordance with the rules on eligibility and selection criteria established at national level. Member States must establish these rules and criteria in order to target limited financial resources towards areas, projects and beneficiaries which contribute most to the objectives of the programme.

## 31

Eligibility breaches accounted for a quarter of the error rate for rural development, equally distributed between private and public beneficiaries. The Court found a wide range of eligibility breaches, reflecting the multitude of investment measures and the large number of implementing rules and criteria applicable to them in Member States.

14 Article 71 of Council Regulation (EC) No 1698/2005 of 20 September 2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) (OJ L 277, 21.10.2005, p. 1).

32

Eligibility breaches can occur at the levels of the beneficiary, of the project and of individual cost items. **Table 2** illustrates examples of such cases.

Table 2

Level of breach	Example
Beneficiary	<p>In Spain, to benefit from aid for investments in processing facilities for agricultural products, enterprises must have fewer than 750 employees and a turnover of less than 200 million euro. Figures for controlling enterprises (up to the ultimate beneficial owner) also have to be taken into account when assessing compliance with these thresholds.</p> <p>A beneficiary submitted a project to expand its production facilities. In the application, he included the data for only half of the companies which formed part of the group. Based on this incomplete information, the beneficiary declared that it complied with the ceilings regarding number of employees and total turnover.</p> <p>The Court recalculated the indicators by including the data for all companies in the group and found that both ceilings had been breached. The beneficiary was thus ineligible.</p>
Project	<p>In Poland, several farmers obtained aid for creating a producer group which would acquire agricultural products from its members and then sell these to third parties (with the intention of obtaining better prices than each separate farmer would otherwise have been able to obtain). One of the conditions for receiving the aid was that the producer group must sell the products to third parties.</p> <p>The Court found that the only client of the producer group was another company which was owned by the same farmers. The audited project was therefore not eligible.</p>
Individual cost items	<p>In Portugal, a beneficiary submitted a project involving planting olive trees. Among other conditions, expenditure was eligible only if it was incurred after the project application had been submitted (as a means of avoiding deadweight and ensuring that only farmers who really needed the aid received it).</p> <p>When reviewing the payment claim, the Court found cost items, representing more than 10 % of the amount claimed, that had been incurred before the date of the application for support. These items of expenditure were therefore ineligible.</p>

33

Member States implemented both EU requirements and their own policy objectives through national and regional legislation; this typically included rural development programmes, implementing regulations, procedure manuals and applicant guides. This has

resulted in a considerable number of rules and requirements being applicable. However, in the opinion of the Court, such rules are often needed to ensure that public funds are used to reach policy objectives and respect the principles of sound financial management.



## Observations

### 34

The Court considers that, for the projects audited, the rules were not unnecessarily complex and did not impose unjustified requirements on beneficiaries and Member State authorities. While limited examples of gold-plating were found, these had only a marginal impact on the error rate.

### 35

There is a risk that Member States may withdraw effective rules in order to prevent errors. Effective rules are important for achieving the objectives of the policy. The Court considers that simplification should not hamper the principles of sound financial management. For example (see **Box 3**), the original Portuguese rule described in the case below is an effective way of excluding investments which would have been made anyway, without public aid. When investments would have been carried out anyway, public support was not necessary. In fact, in several special reports, the Court has criticised the fact that expenditure is eligible before the application is submitted, and recommended that expenditure should only be eligible from grant approval. Thus, in the case concerned, the solution for preventing errors would not be that the Member State would withdraw an effective rule but would prevent errors by better checking the payment claims.

### No eligibility errors found in the measure 'setting up of young farmers'

### 36

The sample of 461 projects audited included 20 under the measure 'Setting up of young farmers'. This support is granted to people aged below 40 who become owners of a farm for the first time. The support is provided in the form of a maximum lump sum payment of 70 000 euro, the aim of which is to help these farmers to set up and develop their farms. Beneficiaries can use the support to purchase land, buildings, equipment, and animals, and to cover working capital requirements.

#### Box 3

### Example of withdrawing an effective eligibility criterion

In Portugal, investments made before submitting an application for support were considered ineligible at the start of the programming period in 2007. The sample of audited cases included two where for certain cost items this rule had not been respected, rendering the expenditure concerned ineligible.

The national rules were amended in 2011. Expenditure incurred before the application for support is submitted is now eligible.

## Observations

### 37

In addition to the basic eligibility requirements (less than 40 years old and setting up a farm for the first time), the Council regulation<sup>15</sup> stipulates two further conditions. Beneficiaries must possess adequate occupational skills and competence, and must submit a business plan. For the 20 projects audited, Member States set a small number of detailed requirements. For example, farmers were required to gain adequate skills and competences within 3 years through training, and to prepare and follow a simplified business plan describing the initial situation of the agricultural holding and specific milestones and targets for the development of the activities.

### 38

While certain procedural weaknesses and concerns regarding sound financial management were identified, the Court did not find any errors of legality and regularity in relation to the manner in which young farmers had prepared and carried out their projects. In the Court's view, this is due to the small number of detailed requirements, the focused scope of the measure and the use of lump sum payments. Of course, schemes such as this one must also deliver value for money and demonstrate sound financial management — and these are beyond the scope of this report. But the example does show that the relative simplicity of a scheme does impact on the level of irregularities.

### Indications that private beneficiaries may have committed intentional irregularities

### 39

Commission Regulation (EU) No 65/2011 states that where a beneficiary is found to have intentionally made a false declaration, the operation in question must be excluded from support and any amounts already paid for that operation must be recovered<sup>16</sup>.

### 40

Fraud may consist of one or more of the following<sup>17</sup>:

- The use or presentation of incorrect or incomplete statements or documents leading to wrongful payment of funds from the EU budget or budgets managed by, or on behalf of, the EU;
- The non-disclosure of required information with the same effect;
- The misuse of funds for purposes other than those for which they were originally granted.

### 41

In 4 % of the private investment projects audited (6 out of 152), the Court found indications that beneficiaries may have committed intentional irregularities. These cases account for one eighth of the average error rate for rural development.

15 Article 22 of Council Regulation (EC) No 1698/2005.

16 Articles 4.8 and 30.2 of Commission Regulation (EU) No 65/2011.

17 Fraud, as applied in Community law, is defined in Article 1 of Council Act of 26 July 1995 drawing up the Convention on the protection of the European Communities' financial interests.

### 42

The Court reports all cases where there are indications of intentional irregularities to OLAF for further analysis and appropriate follow-up. **Box 4** contains an example.

#### **The measure supporting investments in food processing facilities raises the most concerns**

### 43

The rural development measure 'adding value to agricultural and forestry products' made the most significant contribution to the error rate for private investments. This measure targets small and medium-sized enterprises (SMEs) and finances investment in facilities for processing primary products. These facilities include wineries, grain mills, fruit and vegetable processing and packaging lines.

### 44

Of the 19 projects audited for this measure, 10 were affected by error (three of these were reported to OLAF). The main shortcomings noted were non-compliance with the SME criterion and non-respect of appropriate private procurement procedures. Public aid for this measure is typically in the range of several million euro per project. In this context, there is a strong incentive for applicants to circumvent the rules with the aim of receiving aid.

#### **Box 4**

#### **Example of indications of intentional irregularity**

A beneficiary applied for aid under an investment measure whereby the rules stipulated that equipment bought second-hand was not eligible. When presenting the payment claim, the beneficiary declared that the equipment part of the project had been purchased new from a dealer.

During the on-the-spot visit, the Court's auditors found evidence to suggest that the machine had not, in fact, been purchased new. The auditors subsequently obtained third party documentation confirming that the equipment had been bought second-hand.

The expenditure was assessed as ineligible and the case was forwarded to OLAF.

## Observations

### 45

In addition to the above, the Court has recently reported numerous shortcomings in the implementation of this measure, which seriously affected the efficiency and effectiveness of the measure in reaching its policy objectives<sup>18</sup>.

### Member State authorities could have detected and corrected errors affecting investment measures

### 46

Commission Regulation (EU) No 65/2011 stipulates that Member States must establish a control system ensuring that all necessary checks are carried out to verify compliance with the terms under which support is granted. The regulation specifies how such checks must be carried out, including what should be verified, how the samples should be selected and the minimum coverage for each type of support.

### 47

Administrative checks must be carried out on all applications for support and payment claims and must include at least one visit to the operation supported or the investment site to verify its realisation. In addition, on-the-spot checks must be performed annually on a sample of projects representing at least 5 % of the expenditure incurred.

### 48

In the Court's view, Member States could and should have prevented most errors for investment measures from occurring for the following two reasons.

### 49

Firstly, the information necessary to detect and correct the error was available to the Member State authorities, but was either not used or not requested in many instances. The following typical situations were noted:

- the information was available in the supporting documentation submitted by the beneficiary (e.g. dates of invoices), but was not used by the paying agency;
- the information was available at the beneficiary level (e.g. accounting records), but the paying agency did not ask for it;
- the information was available at third party level (e.g. shareholder structure of beneficiary companies), but was not sought by the paying agency.

### 50

Secondly, checks performed by Member State authorities were not exhaustive. Examples of this are included in **Box 5**.

18 Special Report No 1/2013 'Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products?' (<http://eca.europa.eu>).

## Box 5

**Examples of insufficient quality of Member State authorities' checks**

In Poland, a contract co-financed under the technical assistance measure (see paragraph 23) was awarded directly, without the required competitive procedure being conducted. The Court found that the required checks were not performed, as the paying agency did not verify that technical assistance projects complied with public procurement rules.

In Romania, the paying agency performed verifications on the payment claim submitted by the beneficiary for a project providing farm advisory services. The paying agency's control report showed that the difference between the amount claimed by the beneficiary and the amount approved by the paying agency was more than 3 %. The paying agency did not apply the penalty required in cases such as this, because such a check was not carried out for this measure.

In Spain, the cost of the construction works carried out was justified by means of copies of the invoices from the contractor and copies of proofs of payment. These invoices showed that the contractor offered a 5 % discount on the total value of the invoices. Payment records also showed that the beneficiary did not pay the invoices in full, but deducted the 5 % discount. Although the paying agency had verified the invoices and payment records, the expenses were approved in full without deducting the 5 % discount, which represented expenditure which had not been incurred by the beneficiary.

In Sweden, a regional government body did not respect the applicable procurement rules (see **Box 2**). The Court found that the paying agency had delegated the tasks of approving aid applications and payment claims for the project audited to the regional government body concerned. At the same time, the body received the aid as the beneficiary. The regional government body had not checked compliance with national public procurement rules as part of the administrative checks.

**51**

The Court's system examinations confirm that the quality of the checks performed by Member States is insufficient. The Court has assessed the quality of key aspects of supervisory and control systems for investment measures for 14 paying agencies in 13 Member States<sup>19</sup> over the past 3 years. No paying agencies were assessed as having effective systems with regard to administrative checks and only five were assessed as being effective with regard to their systems for on-the-spot checks.

**52**

For investment measures, most errors occur at the initial stage of application for support and the procurement stage which follows. Verifying applications for support is a complex and often time-consuming procedure.

<sup>19</sup> See Annex 4.2 of the Court's Annual Reports for 2011, 2012 and 2013.

**53**

The Court notes that difficulties encountered at this stage may be partly caused by inefficiencies in paying agencies' procedures. Paying agencies typically perform the full set of verifications on applications for support even if, at a certain point in the verification process, it becomes clear that the application is not eligible. Thus, any time spent continuing verifications after the ineligibility has been established represents a source of inefficiency.

**54**

In the context of limited financial resources, especially at the end of the programming period, it may be that only a small fraction of the applications for support can be co-financed (the applications which receive the highest numbers of selection points). However, some paying agencies perform the full set of verifications on all applications submitted, even if many of the eligible projects will not receive aid because they will not have enough selection points. In this context, the paying agency for the Italy-Sicily region uses an efficient procedure, which is described in **Box 6**.

**Box 6****Example of best practice in evaluating applications for support**

In Italy-Sicily, applications for support are evaluated in two stages.

In the first stage, a limited number of checks are performed on all applications; these are then published in a preliminary selection report. Projects are selected in descending order of the number of selection points awarded to them, until the total value of projects selected reaches the allocated budget.

In the second stage, full verifications are only performed for those projects which passed the preliminary selection procedure. If, among these, ineligible projects are found, these are replaced by the highest scoring projects which were not selected initially.

### **PART II** **What are the main causes of the error rate in area-related aid?**

#### **55**

This section examines the causes of errors in area-related aid. While the total budget is equally split between investment measures and area-related aid, the latter contributed to only a third of the error rate (see **Figure 2**). The main impact on the error rate was due to non-compliance with agri-environment commitments, as opposed to aid for less-favoured areas.

#### **Agri-environment aid is the most error prone area-related measure**

#### **56**

Agri-environment payments are granted to farmers who undertake to comply on a voluntary basis with certain commitments to fulfil environmental objectives. Payments are intended to cover additional costs and income foregone as a result of environmentally friendly farming practices undertaken for a period of 5 to 7 years. Agri-environment is the most financially significant rural development measure, to which approximately 20 billion euro has been allocated (a fifth of the total rural development budget for the 2007–13 programming period).

#### **57**

Infringements of agri-environment commitments accounted for one eighth of the total error rate. Errors were primarily the result of non-respect of simple commitments (see **Box 7**), which, however, significantly hampered the achievement of the desired environmental benefits.

Box 7

**Examples of non-respect of simple agri-environment commitments**

In the Netherlands, a farmer entered into a contract for the 'Botanical grassland edges' measure.

Of the three commitments, one was related to dredging (in order to protect biodiversity, it was prohibited to cover the edge of the meadow with the mud dredged out of the water channels).

During the on-the-spot visit, the Court found that instead of being evenly spread, the mud excavated had been deposited on a 2 metre strip of land along more than 4 000 metres of channels.



Source: European Court of Auditors.

In the United Kingdom (England), a farmer received aid for permanent grassland with very low inputs (e.g. fertilisers). One of the requirements was to avoid overgrazing, so that the growth, quality or diversity of the vegetation is not adversely affected.

The Court found that part of the parcel was damaged due to overgrazing.



Source: European Court of Auditors.

In Malta, a farmer undertook to refrain from cultivating crops on a strip measuring a minimum of one metre along fences, and to leave this area uncultivated, unploughed, unfertilised and unsprayed. This commitment aimed at conserving the biodiversity.

The Court found that the beneficiary did not comply with this obligation on any of the parcels of land subject to this commitment.



Source: European Court of Auditors.



58

The Court considers that there are three reasons which, combined, explain the error rate for agri-environment measures. They are presented graphically in **Figure 7** and described in further detail in the following paragraphs.

**Compliance with commitments does not produce an immediate positive effect for the farmer**

59

Farmers are directly impacted by the costs of complying with commitments and/or the loss of revenue because of the lower yields obtained by using more environmentally friendly techniques. In most cases, however, these efforts are not rewarded by immediate positive effects on the farm. Thus, farmers are less likely to comply when

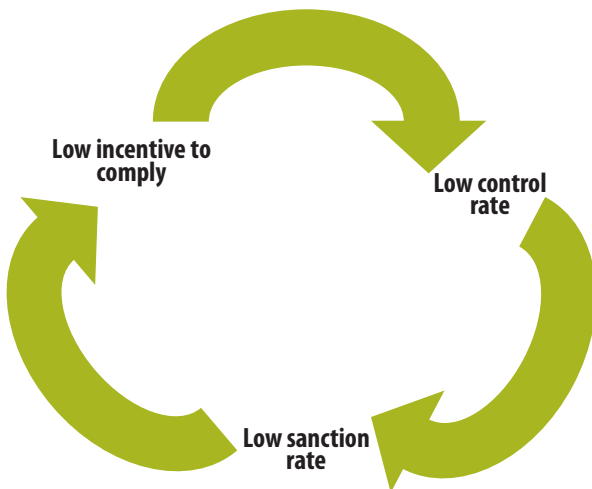
there is no direct immediate relationship between the commitments undertaken and the results on their farming activity.

60

This was the case in 13 out of the 17 errors identified, where the benefits brought about by the measures were far-reaching, long-term environmental benefits (such as for example, protecting biodiversity).

Figure 7

Reasons for the error rate for agri-environmental payments



## Observations

### 61

The Court did not find that a lack of knowledge regarding the commitments was a valid explanation for the majority of infringements made by farmers. Before signing the commitment, farmers are presented with the detailed list of conditions they must respect. Furthermore, in 13 out of the 17 cases, the error applied to large farmers with extensive knowledge and resources. In fact these farmers had over 50 hectares in area, deriving their main income from agriculture.

### Low control rate for agri-environment commitments

### 62

Member States verify the respect of most agri-environment commitments only during on-the-spot checks, which are performed on a sample of 5 % of all beneficiaries receiving aid. This means that, on average, there is a probability that a farmer is checked once every 20 years. In addition, not all commitments can be checked at any point of time during the year, thereby reducing the scope of controls and the potential of detecting non-compliances. This low control rate for commitments is another reason for the error rate found.

### 63

Among the 17 cases of errors found, the Court identified eight instances where the verification of commitments could have been shifted from the on-the-spot controls to administrative controls (see example in **Box 8**). Such a change in procedure would have enabled the Member State authorities to correct and detect the errors during administrative checks, as such checks are performed on 100 % of all beneficiaries. This would be especially appropriate for checks based on documentary evidence, such as: activity registers kept by the farmer (fertilisation, animal grazing, grass mowing) and certificates issued by third parties.

#### Box 8

### Example of agri-environment commitment which could have been verified by administrative checks

In Estonia, one of the commitments of the measure was that the farmer should take at least one soil sample for every 5 hectares of land held and send it to an accredited laboratory for analysis of the acidity of the soil and its phosphorus and potassium content. The rules stipulated that the laboratory results were to be kept on the farm and made available to inspectors during on-the-spot visits.

During the Court's auditors on-the-spot visit, the farmer presented the laboratory results of the nine soil samples taken. Upon recalculation, it was determined that, based on the area of the parcels, the farmer should have taken 13 samples, rather than just nine. This non-compliance with the commitments could have been detected through administrative checks.

### The system of reductions and sanctions does not have a strong deterrent effect

#### 64

Member States apply a proportional system of reductions and sanctions which, based on the severity, extent and permanence of the infringement, normally results in a partial reduction of the payment made. For example, in the case described in **Box 8**, a 5 % reduction for non-compliance with the commitment was applied. Farmers do not risk losing any of their own money because of non-compliance, but only risk having to return what has already been paid to them. In extreme cases, where farmers have not performed any of the commitments made and the paying agency decides to recover the entire payment made, the farmers could find themselves in the same situation as if they had not entered into any commitment.

#### 65

In this context, the frequency of errors (17 out of the 121 payments audited) also points to the fact that the system of reducing payments in cases of non-compliance has only a limited deterrent effect on farmers (see an example in **Box 9**).

### Payments for less-favoured areas are less affected by error

#### 66

Payments to farmers in mountain areas and in other areas with natural handicaps (together commonly referred to as 'less-favoured areas' or 'LFA') compensate farmers for continuing to farm in these areas. These rural development measures target the sustainable use of agricultural land and thus contribute to improving the environment and the countryside.

#### Box 9

### Limited financial consequences of an infringement

In the United Kingdom, a farmer entered into a commitment related to establishing heathland vegetation on acid grassland. There were only two commitments under the measure: reduction of the stocking density (the number of animals grazing per hectare) and the prohibition of grazing between October and March.

The Court visited the farmer in October and found that animals were still grazing on the parcels. The financial consequence for the farmer was a 3 % reduction of the payment.

## 67

The impact of the 78 LFA payments audited on the overall error rate would have been negligible, were it not for two cases where errors were found for non-respect of additional eligibility conditions imposed by the Member States concerned (see **Box 10**). This illustrates the dilemma that eligibility conditions are required to ensure that the funds are well spent, which may at the same time increase the risk of error.

## 68

This relatively low error rate is due to the main characteristics of the measures concerned:

- a small number of detailed eligibility conditions: the land must be located in a designated area, defined by the Member State and approved by the Commission, and must be maintained in good agricultural and environmental condition;

- lump sum payments per hectare, which are degressive. This means that bigger farms will receive lower payments for areas which exceed a certain threshold, and that for such farms potential area differences only have a small impact.

## 69

The Court notes that the low error rate for the investment measure ‘setting up of young farmers’ was also explained by these characteristics, i.e. a limited number of detailed requirements, a focused scope and the use of lump sum payments.

### Box 10

#### Additional eligibility conditions imposed by Member States for LFA payments

In Italy and Portugal, the eligibility of pastures in mountain areas was conditional upon the beneficiary owning a minimum number of animals. During on-the-spot visits, the Court found that the farmers concerned did not have the required number of animals and that the pastures were therefore not eligible for support.

These two cases made up the majority of the error rate affecting LFA payments.

### **PART III** **Do the Member States' action plans and the new EU legal framework have the potential to address these causes effectively?**

#### **70**

The Commission and the Member States have taken steps to address the causes of error in rural development. This section examines whether the two main steps — the action plans and the EU legal framework — are likely to be effective.

**The action plan exercise initiated by the Commission is a step in the right direction in addressing the causes of error**

#### **71**

Rural development expenditure is implemented by shared management between the Member States and the Commission<sup>20</sup>. In line with the subsidiarity principle, Member States are responsible for implementing the rural development programmes at the appropriate territorial level, according to their own institutional arrangements. The Commission is responsible for supervising Member States to ensure that they fulfil their responsibilities.

#### **72**

If, during implementation, the level of error is persistently high, the Commission<sup>21</sup> has to identify the weaknesses in the control systems, analyse the costs and benefits of possible corrective measures and take or propose

appropriate action. When weaknesses lead to a reservation in the Director-General's Declaration of Assurance, the Commission is required to analyse the information in the annual activity report and present an action plan. This has been the case for rural development expenditure since 2011.

#### **73**

In this context, in an effort to reduce the error rate in rural development spending, the Commission invited all Member States to develop a three-fold action plan in order to identify the causes of error, to implement targeted corrective action aimed at reducing the errors observed and to reinforce the preventive measures to reduce the risk of occurrence of errors.

**The action plans are not yet a fully developed tool to address the causes of error**

#### **74**

The scope and quality of the action plans varied significantly from one Member State to another. The Court found that two action plans (Germany — Berlin-Brandenburg and Hungary) were relatively poor, with few actions and low potential of success in addressing the causes of error, and two (Italy-Lombardy and Romania) were relatively good, with numerous actions and high potential of success in addressing the causes of error. There are three main weaknesses at the root of this variability in the action plans' potential effectiveness, as explained in the subsequent paragraphs.

20 Council Regulation (EC) No 1290/2005.

21 Regulation (EU, Euratom) No 966/2012.

## Observations

### 75

Firstly, Member States did not assume their responsibility for the identification of errors and the proposal of corrective actions. Action plans are subject to a formal monitoring and follow-up procedure. When Member States do not implement proposed actions, they may be subject to interruption, suspension or reduction of payments and financial corrections. Action plans were developed under

an iterative process, with a fourth update being in progress when the audit work was completed. The Commission initially communicated a non-exhaustive list of causes of errors. However, not all these causes were addressed by Member States and, out of those which were, some have a limited potential to address the causes of error (see **Box 11**). Subsequently, the action plans were gradually improved in response to the Commission's requests.

#### Box 11

### Example of a proposed action to reduce the error rate

The system of reductions and sanctions was one of the potential causes of error in area-related aid, identified by the Commission and addressed by Member States. The system was not considered to be proportionate (in some cases, Member States applied a 100 % reduction in payment even if only one out of several commitments had been breached).

The Court agrees that adjustments made to the reduction and sanction system should ensure that any such system appropriately reflects the level of non-fulfilment of the environmental objective pursued.

However, while a decrease in the sanctions applied will reduce the error rate, this will not address the underlying infringements and their potentially detrimental impact on the environment. As such, sanctions must act as an effective deterrent to farmers from breaching their obligations. This was not accomplished in the case shown in **Box 9**.

### 76

Secondly, four out of the 10 action plans examined did not systematically address the audit findings from the Commission and the Court. Member States did not take into account all the weaknesses reported by Commission auditors by the closure of the conformity audit procedures, meaning that causes of errors are likely to remain unaddressed for a further period<sup>22</sup>.

22 The Commission carries out conformity audits in the Member States to check that the expenditure has been paid in compliance with the applicable rules. The audit is closed with or without financial corrections depending on the errors found. The average length of the conformity procedure of the audits closed in 2013 was 36 months.

**77**

Thirdly, a majority of the actions proposed were designed along general lines. Most Member States propose general solutions such as updating procedure manuals or organising training courses. For example, in relation to public procurement, a recurrent solution was to train inspectors and beneficiaries in relation to the applicable public procurement rules. However, the action plans do not analyse which aspects of the rules were most likely to be breached and why. In this context, there is a risk that the effectiveness of the proposed measures is undermined.

**78**

The Court also found examples of best practices in the design of appropriate responses to the problems identified (see **Box 12**). The Commission organises twice-yearly seminars with representatives from all Member States as an opportunity to discuss the status of implementation of the action plans, to share experience and to disseminate best practices.

**Insufficient focus on preventing widespread weaknesses at EU level**

**79**

Action plans address the weaknesses specifically identified in each Member State, without including preventive actions for weaknesses detected in other countries. The Commission did not request Member States to systematically address the most serious widespread deficiencies encountered at EU level, such as non-compliance with public procurement rules, intentional irregularities and insufficient administrative checks of agri-environmental commitments.

**Box 12**

**Best practices in designing concrete targeted actions**

In Bulgaria, farmers receive SMS messages from the paying agency, to inform them of time-bound commitments (periods when certain practices are prohibited).

In Italy-Lombardy, farmers are notified in writing about area differences between the area claimed in the previous campaign and the area resulting from the refresh of the land parcel identification system (the IT system identifying the location and area of the agricultural parcels).

In Romania, the paying agency obtained full and free access to the register of commerce which provides the information to verify SME status.

## Observations

### 80

The Court examined 10 action plans to check whether they include actions to remedy widespread deficiencies. This was not the case. Three Member States did not include any actions in the field of public procurement, five did so in a general manner, while only two (Latvia and Romania) designed detailed checklists. The Court found that infringements of agri-environment commitments could be detected through administrative checks (see paragraph 63), but only one Member State (Spain) addressed this issue in its action plan, and then only for 7 of the 17 regions. The detection of intentional irregularities was only included in one action plan (Romania).

### 81

In this context, action plans are a step in the right direction, but mainly have a reactive role. The fact that Member States did not address EU-wide problems which they did not consider applicable to them reduces the future effectiveness of these plans.

### **The new EU legal framework may have a positive effect in addressing the causes of errors**

### 82

The 2014–20 rural development programming period will be implemented as part of the reformed common agricultural policy, which was enacted through a set of four basic regulations<sup>23</sup> and the related delegated and implementing acts<sup>24</sup>.

### 83

As part of its statutory role, in 2012 the Court issued Opinion No 1/2012 on certain proposals for regulations relating to the common agricultural policy for the period 2014–20<sup>25</sup>. Whereas Opinion No 1/2012 expressed views on all aspects of the common agricultural policy, mainly from the perspective of sound financial management, this special report addresses only the likely impact of the new legislation on the causes of errors of legality and regularity in rural development.

### **The new legislative package contains factors which may address causes of errors**

### 84

The new legal framework introduces the concept of *ex ante* conditionality, meaning a concrete and precisely pre-defined critical factor, which is a prerequisite for and has a direct and genuine link to, and direct impact on, the effective and efficient achievement of a specific objective<sup>26</sup>. Public procurement is one of the general *ex ante* conditionalities in the legislation, which stipulates that appropriate arrangements must be in place for the effective application of EU public procurement rules, to ensure that contract award procedures are transparent, that the staff involved are trained and that relevant information is disseminated to them. The Court welcomes this focus on compliance with applicable public procurement rules, which were identified as one of the critical sources of error in the 2007–13 programming period.

23 [http://ec.europa.eu/agriculture/cap-post-2013/legislation/index\\_en.htm](http://ec.europa.eu/agriculture/cap-post-2013/legislation/index_en.htm)

24 [http://ec.europa.eu/agriculture/cap-post-2013/implementation/index\\_en.htm](http://ec.europa.eu/agriculture/cap-post-2013/implementation/index_en.htm)

25 [http://www.eca.europa.eu/Lists/ECADocuments/OP12\\_01/OP12\\_01\\_EN.PDF](http://www.eca.europa.eu/Lists/ECADocuments/OP12_01/OP12_01_EN.PDF)

26 Article 2(33) of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).



### 85

Although it was already covered in the general principles of control for the 2007–13 programming period, the verifiability and controllability of measures<sup>27</sup> is highlighted in the new legislation. Under the new rules, Member States must ensure that all rural development measures are verifiable and controllable, both *ex ante*, before they are actually implemented, and subsequently, during implementation. The Court considers that this approach is likely to help reduce the error rate in two ways; on the one hand, by making it possible to define eligibility criteria and other commitments more precisely so that they can be better understood and complied with by beneficiaries, and on the other hand, it will allow control procedures to be better designed to ensure that such criteria can be verified effectively.

### 86

The methods for establishing and reimbursing costs incurred by beneficiaries are also improved in the new legislation. Thus, in addition to the usual method of reimbursement based on the eligible costs actually incurred and paid by beneficiaries, the new legal framework places alternative methods such as standard costs, lump sum payments and flat rate financing on an equal footing with reimbursement. The Court considers that the use of these simplified cost methods is likely to be beneficial for all parties, because it may reduce the administrative formalities and may limit the scope of errors related to preparing and verifying payment claims based on invoices and payment documents.

### 87

Accredited paying agencies will have to comply with additional criteria with regard to fraud. While the requirement that checks should include those elements to prevent and detect fraud has been carried forward, two new provisions underline the role of the paying agencies in this respect: staff training should include fraud awareness and monitoring activities should include also the procedures to prevent and detect fraud. These developments are likely to help paying agencies increase their effectiveness in the prevention and detection of fraudulent actions.

### 88

The ‘n+2 rule’ as it existed in the 2007–13 programming period (see paragraph 18) has been relaxed and transformed into a ‘n+3 rule’<sup>28</sup>, giving Member States an additional year to spend the allocated budget. This could reduce the imbalance between the pressure on Member States to spend the budget, and the need to ensure that it is spent correctly and in accordance with the principles of sound financial management.

### 89

As a general rule, the beneficiaries of investment in food processing activities had to be small and medium-sized enterprises (see paragraph 43). The new legal framework removes this eligibility criterion, which was one of the main causes of error for this type of investment. The impact of this proposal may have a positive effect on reducing the error rate, but a negative effect on the effectiveness of the policy (see paragraph 35).

27 Article 62 of Regulation (EU) No 1305/2013 of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005 (OJ L 347, 20.12.2013, p. 487).

28 Article 38(1) of Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No 352/78, (EC) No 165/94, (EC) No 2799/98, (EC) No 814/2000, (EC) No 1290/2005 and (EC) No 485/2008 (OJ L 347, 20.12.2013, p. 549).

### 90

In the 2007–13 programming period<sup>29</sup>, in case of a difference of more than 3 % between the payment claimed by the beneficiary and the amount declared eligible by the paying agency, a penalty equal to the amount of that difference was applied. This system was in place in order to deter beneficiaries from claiming expenditure which was not eligible. Under the new legal framework<sup>30</sup>, the threshold for the application of the penalty has been raised to 10 %. This change is likely to reduce the dissuasive effect of the provision, which may lead to an increase in ineligible expenditure included in the payment claims.

#### **Direct provisions from the EU regulations were not the main source of error**

### 91

As shown above, the new EU legal framework is likely to help reduce the error rate. Additional attention needs to be given during the subsequent steps of the regulatory process at Member State level, as most errors occur in the implementation of specific provisions in Member State legislation (see paragraph 14).

### 92

Since the Member States' legislation has not yet been approved (see paragraph 10), no further insights could be obtained into the potential effect of regulatory changes on the error rate.

- 29 Article 30(1) of Commission Regulation (EU) No 65/2011.
- 30 Article 63(1) of Commission Implementing Regulation (EU) No 809/2014 of 17 July 2014 laying down rules for the application of Regulation (EU) No 1306/2013 of the European Parliament and of the Council with regard to the integrated administration and control system, rural development measures and cross compliance (OJ L 227, 31.7.2014, p. 69).

## 93

The Court concludes that the Commission and the Member States are partially effective in addressing the main causes of the high error rate for rural development. This overall conclusion is mainly based on the assessment that, despite the Commission's initiatives, Member States' action plans did not systematically address the weaknesses identified.

## 94

In order to identify the causes of errors in rural development spending, the Court analysed a sample of transactions selected randomly during the legality and regularity audits for 2011, 2012 and 2013. The results showed that, despite an equal share of expenditure, investment measures account for two thirds of the error rate and area-related aid for the remaining third (paragraphs 12 to 21).

## 95

For investment measures, the causes of errors can be identified in two ways (paragraphs 22 to 54):

- from the beneficiary perspective, the main sources of non-compliance related to public procurement, eligibility criteria for private and public beneficiaries and suspected fraudulent actions by private beneficiaries;

- from the paying agency perspective, the Court concludes that most errors could and should have been prevented during administrative and on-the-spot checks.

## 96

For area-related aid, three factors explain the error rate: limited incentives for beneficiaries to comply with farming commitments, a low control rate for farming commitments and weak deterrence by the sanction system (paragraphs 55 to 69).

## 97

As a response to the high error rate in rural development, the Commission asked Member States to develop action plans to prevent and correct the causes of errors. While this is a positive development, the action plans mainly have a reactive role, and do not systematically address the problems that caused the errors in all Member States. In particular, there is a lack of preventive action against widespread weaknesses at EU level (paragraphs 70 to 81).

## Conclusions and recommendations

### Recommendation 1

The Commission should complete its corrective actions to date by continuing to focus on the root causes of error for rural development spending. In this regard the following preventive and corrective actions should be taken by the Member States where relevant:

#### *Public procurement*

- In the application of the concept of *ex ante* conditionality (see paragraph 84) Member States should develop and provide detailed guidance to beneficiaries on how to apply public procurement rules. The national authorities specialising in monitoring compliance with public procurement rules should be involved in this process. Focus should be put on the three main breaches of rules: unjustified direct award without proper competitive procedure; misapplication of selection and award criteria; lack of equal treatment of tenderers.

#### *Intentional circumvention of rules*

- Based on the specific eligibility and selection criteria from their rural development programmes, Member States should establish guidelines to help their inspectors to identify indicators of suspected fraudulent actions.

#### *Agri-environment payments*

- Member States should increase the scope of their administrative controls, to include commitments which can be checked based on documentary evidence and which are currently verified only during the 5 % on-the-spot checks. In addition, the system of reductions and sanctions should be designed to have an effective dissuasive effect on potential rule-breakers.

### 98

The EU legal framework for the 2014–20 period has been adopted, and this is a potential means of addressing causes of error. However, two stages which are currently ongoing provide the main potential for reducing errors: the Commission's review and approval of rural development programmes, and the Member States' implementation of national regulatory frameworks (paragraphs 82 to 92).

### Recommendation 2

The Commission should closely monitor the implementation of the RDPs and in its conformity audits take account of the applicable rules including those adopted at national level where relevant, in order to reduce the risk of repeating weaknesses and errors encountered during the 2007–13 programming period.

## Conclusions and recommendations

### 99

The Court identified one investment measure (setting up of young farmers, see paragraphs 36 to 38), and two area-related measures ('payments for less-favoured areas', see paragraphs 66 to 69) which had low error rates. These measures have three main characteristics: a focused scope, a limited number of requirements and the use of lump sum payments. The Court found that another investment measure, which supports investment in the processing of agricultural products, was the most prone to error. More than half of the projects audited had errors, a third of which were due to suspected fraudulent actions. The Court criticised the effectiveness of this measure in a previous special report.

### Recommendation 3

The Commission and the Member States should analyse:

- to what extent the characteristics of a more focused scope, limited eligibility criteria and the use of simplified cost options can be replicated into the design and implementation of an increased number of support measures, without jeopardising the overall objectives of those measures;
- how to improve the scheme for supporting investments in the processing of agricultural products, taking into consideration the following elements:
  - the actual need for public aid for this sector and the risk of deadweight;
  - the categories of beneficiaries targeted: farmers looking to achieve vertical integration of their businesses, or companies which have no agricultural activity;
  - the high public aid ceiling, which constitutes an incentive for large corporations, as only they have access to the required co-financing;
  - the entire set of eligibility conditions and the potential for circumventing them;
  - greater efforts to improve the design and performance of administrative and on-the-spot controls.
- the agri-environment payments measure so that, as far as possible, commitments can be controlled via Member States' administrative checks.

### 100

In the context of reducing the causes of error, a recurring finding in this report (see paragraphs 33 to 35, 38, 67, 88 to 90, **Box 3** and **Box 11**) has been the need to maintain an appropriate balance between the number and complexity of rules, as a transposition of the need to achieve pre-defined objectives, and the need to guarantee

the legality and regularity of spending. In the Court's opinion, finding the right balance between these two counterweights is the key to the successful implementation of the rural development policy.

This report was adopted by Chamber I, headed by Mrs Rasa BUDBERGYTĖ, Member of the Court of Auditors, in Luxembourg at its meeting of 17 December 2014.

*For the Court of Auditors*



Vítor Manuel da SILVA CALDEIRA  
*President*

## List of rural development measures

Investment measures		
Measure	Expenditure <sup>1</sup> (euro)	Transactions audited
Modernisation of agricultural holdings	8 204 333 653	53
Basic services for the economy and rural population	1 965 164 204	24
Setting up of young farmers	2 096 198 537	20
Village renewal and development	2 300 229 913	20
Adding value to agricultural and forestry products	2 990 722 693	19
Implementing local development strategies. Quality of life/diversification	1 707 595 920	17
Infrastructure related to the development and adaptation of agriculture and forestry	2 355 539 793	15
Early retirement	2 051 938 167	13
Business creation and development	881 435 718	9
Conservation and upgrading of the rural heritage	682 545 431	8
Restoring forestry potential and introducing prevention actions	963 189 776	5
Technical assistance	763 706 346	4
Diversification into non-agricultural activities	714 070 708	4
Vocational training and information actions	518 543 051	4
Encouragement of tourism activities	482 748 900	4
Restoring agricultural production potential damaged by natural disasters and introducing appropriate prevention actions	348 644 877	4
Cooperation for development of new products, processes and technologies in the agriculture and food sector and the forestry sector	113 588 163	4
Running the local action group, acquiring skills and animating the territory	545 795 172	3
Holdings undergoing restructuring due to a reform of a common market organisation	146 941 744	3
Implementing local development strategies. Competitiveness	145 665 094	3
First afforestation of agricultural land (establishment costs)	1 226 065 545 <sup>2</sup>	2
Non-productive investments linked to forests	379 677 940	2
Semi-subsistence farming	609 703 070	1
Non-productive investments linked to agri-environmental commitments or Natura 2000	315 192 539	1
Producer groups	152 989 100	1
Use of advisory services	89 316 108	1
Participation of farmers in food quality schemes	65 390 549	1
Setting up of management, relief and advisory services	24 853 320	1

1 Cumulative amounts paid to the Member States since the beginning of the programming period (2007) until the end of the 2013 financial year (15 October 2013), as registered in the Commission's SFC database.

2 First afforestation for agricultural land supports establishment costs (investments made for the preparation of the land and planting) and area-related aid (maintenance and compensation). No distinction is made in the declaration of expenditure to the Commission.

Investment measures		
Measure	Expenditure <sup>1</sup> (euro)	Transactions audited
Provision of farm advisory and extension services in Bulgaria and Romania	7 136 945	1
Improvement of the economic value of forests	211 138 607	0
First afforestation of non-agricultural land (establishment costs)	111 889 830	0
Skills acquisition, animation and implementation of local development strategies	73 558 357	0
Information and promotion activities	66 792 678	0
Meeting standards based on Community legislation	59 547 670	0
Training and information	58 573 586	0
Implementing cooperation projects	46 980 838	0
Implementing local development strategies. Environment/land management	21 311 569	0
First establishment of agroforestry systems on agricultural land	536 880	0
<b>Total</b>	<b>33 499 252 991</b>	<b>247</b>
Area-related aid		
Measure	Expenditure (euro)	Transactions audited
Agri-environment payments	18 616 040 063	121
Natural handicap payments to farmers in mountain areas	6 267 068 345	43
Natural handicap payments to farmers in areas other than mountain areas	6 357 074 251	35
Animal welfare payments	409 206 501	8
First afforestation of agricultural land (annual payment during 5 years for maintenance costs or compensation for the loss of income during 15 years)	1 226 065 545 <sup>2</sup>	6
Natura 2000 payments and payments linked to the Directive 2000/60/EC	165 985 883	1
Forest-environment payments	40 496 635	0
Natura 2000 payments	33 193 755	0
Complements to Direct Payments for Bulgaria and Romania	436 997 683	0
<b>Total</b>	<b>33 552 128 661</b>	<b>214</b>

1 Cumulative amounts paid to the Member States since the beginning of the programming period (2007) until the end of the 2013 financial year (15 October 2013), as registered in the Commission's SFC database.

2 First afforestation for agricultural land supports establishment costs (investments made for the preparation of the land and planting) and area-related aid (maintenance and compensation). No distinction is made in the declaration of expenditure to the Commission.



## Executive summary

### II

The Commission welcomes the Court's report on the analysis of the root causes of errors which summarises the results of the last 3 years of Statement of Assurance exercise and largely confirms the main conclusions already drawn by the Commission in its Staff Working Document on the assessment of root causes of errors in the implementation of rural development policy and corrective actions presented to the European Parliament and Council in June 2013<sup>1</sup>.

The Court reports an average error rate 2011–13 for rural development of 8,2 %. Nevertheless, the Commission notes the slight downward development in the error rate for EAFRD (8,4 % in 2011 to 7,9 % in 2013).

This error rate is higher than the individual rates published annually by the ECA in Chapter 4 of the annual report. The reason is that the present analysis covers 461 transactions out of 532 in total for the 3 years (which include health, environment and fishery policies). The 71 transactions not concerned by this report have a lower average error rate. The Commission also notes that the Court defines the sample and calculates on a yearly basis the error rate at policy level (rural development, environment, fisheries and health).

The rural development represents 90 % of the policy expenditure and it is generally more prone to errors than other areas in the policy group. The complexity of some eligibility requirements in the rural development measures played an important role in the high level of error rates.

<sup>1</sup> SWD(2013) 244 of 27.06.2013.

### III

Since 2012, the Commission has been addressing the issue of high error rate by requesting national action plans from the Member States (MS) and monitoring their implementation. Based on experience gained and on recommendations from the Court of Auditors, these action plans have been improved over time.

The expected results of all the actions will not always be evident in the short-term, especially for measures implemented through multiannual commitments. Nevertheless, the first results of the joint efforts to reduce error rates through the implementation of the action plans can already be seen in a lower error rate for rural development in 2013.

The Commission will keep on monitoring the implementation of the action plans, both from the audit and operational perspectives, through bilateral meetings, monitoring committees and annual review meetings.

### V

The Commission has also found weaknesses regarding the public procurement in its own audits. Substantial financial corrections have already been made in this respect.

Public procurement is one of the central elements in the action plans for rural development.

Nevertheless, it should be noted that the non-compliance with procurement rules does not necessarily mean that 100 % of the expenses involved are ineligible. The project as such may well achieve its goal and provide real added value.

For the period 2014–20, the Commission has already presented guidance for practitioners on the avoidance of common errors in European Structural and Investment Funds projects. These guidelines were presented to the managing authorities and paying agencies at the Seminar on Error Rate that took place in October 2014.

### VI

Substantial shortcomings regarding the measure supporting the processing of agricultural products are followed up in the audit conformity procedures.

As regards intentional infringements, the Commission is implementing an anti-fraud strategy, organising dedicated seminars in several Member States.

The Commission shares this conclusion.

The Commission will continue providing the Member States with the recommendations and guidelines, as well as disseminating best practices to improve the control system in order to avoid errors.

Furthermore, the paying agencies must comply with the accreditation criteria laid down in Annex I of Regulation 907/2014 (programme 2014–20) before any payments are made. Commission services reviews the accreditation through *ex post* audits.

### VIII

As regards limited incentives for beneficiaries to comply with farming commitments, agri-environmental schemes reflect voluntary commitments by farmers to provide environmental benefits and public goods which go beyond the mandatory requirements. The compensatory nature of agri-environment payments (covering costs incurred and income foregone) does not imply immediate economic benefits for the farmers, although these are not excluded in the longer run.

As regards the 'low' control rate for commitments, according to the legislation in force, where on-the-spot checks reveal a significant non-compliance, the Member State is obliged to increase the percentage of beneficiaries to be checked on the spot. The correct application of this is verified during the Commission conformity audits.

The control rate for farming commitments is established at 100 % for the administrative checks and 5 % for the on-the-spot checks. The costs of management and controls published in the 2013 AAR amount to EUR 4 billion for the whole CAP. Therefore, the emphasis should be put on the improvement of effectiveness of the controls and not on their increase.

As regards the sanctions, the Commission considers that while sanctions for non-compliance have to be proportionate they shall remain a dissuasive tool.

### IX

The establishment of the action plans was conceived as a preventive process based on the Staff Working Document (2013) 244, built on the self-assessment of the Member States of the root causes that had an impact on the error rates. This process has progressively incorporated the reactive perspective, systematically taking into account the audit findings and proposing specific corrective actions. The double perspective (preventive and reactive) is still part of the exercise. The last update of the action plans shows that almost 50 % of the actions were triggered by concrete audit findings of the Court or the Commission, whilst the other half were based on self-assessment of the Member States.

Furthermore, the *ex ante* assessment on the verifiability and controllability of all measures included in the RDPs 2014–20 also address the risk of error rate from a preventive perspective.

### X

The Commission shares the view that it is important to strike an appropriate balance between the number and complexity of rules on the one hand, while guaranteeing the legality and regularity of expenditure.

### XI (a)

The Commission accepts the recommendation. The specific issues raised by the Court should only be dealt with in the action plans if shortcomings have been identified. The Commission recognises the importance of guidance related to the three root causes of errors and dissemination of best practices. This will be dealt with through the European Network for Rural Development and the seminars.

Furthermore, the Commission has already presented to Member States specific guidance on public procurement and Agro-Environment-Climate measure, including double financing.

Intentional circumvention of rules is part of the Anti-fraud strategy and the seminars organised thereof in several Member States.

### XI (b)

The Commission accepts this recommendation. The Commission is currently assessing the controllability and verifiability of the new programmes and will raise any shortcoming in the framework of the monitoring committees and annual review meetings with the managing authorities.

Moreover, audit findings will be closely followed in order to detect and correct any source of error attributable to the national implementing rules, requesting immediate modifications if needed.

Lessons drawn from the implementation of the programmes and national rules thereof, will be shared through the ENRD and dedicated seminars on error rates.

### XI (c)

The Commission partially accepts the recommendation as it cannot prejudge the scope and the result of such analysis or future policy choices by the legislators for the next programming period.

In 2017 the Commission will prepare a strategic report of the Fund, summarising the annual progress reports submitted by Member States (Article 53 Regulation 1303/2013). Furthermore, the Commission and the Member States will assess the performance of the RDPs during the review process foreseen under Article 21 Regulation 1303/2013. In the light of these and other evidences (e.g. audit findings), the Commission will assess the policy conception and the eventual need to make proposals for the following programming period.

At the end of the programming period, the Commission will make a thorough analysis of the continued need for each support measure before making a proposal for the following programming period as has been done for the present period.

The Commission agrees that administrative checks should be used when possible, although it notes that in most cases this is not feasible for agro-environment operations.

## Introduction

### 01

The EU allocated 96 billion and contribution of the Member States is expected at 55 billion.

### 04

The Court reports an average error rate 2011–13 for rural development of 8,2 %. Nevertheless, the Commission notes the slight downward development in the error rate for EAFRD (8,4 % in 2011 to 7,9 % in 2013).

This error rate is higher than the individual rates published annually by the ECA in Chapter 4 of the annual report. The reason is that the present analysis covers 461 transactions out of 532 in total for the 3 years (which include health, environment and fishery policies). The 71 transactions not concerned by this report have a lower average error rate. The Commission also notes that the Court defines the sample and calculates on a yearly basis the error rate at policy level (rural development, environment, fisheries and health).

The rural development represents 90 % of the policy expenditure and it is generally more prone to errors than other areas in the policy group. The complexity of some eligibility requirements in the rural development measures played an important role in the high level of error rates.

### 05

Error rates do not necessarily imply that policy objectives are not attained, which could only be stated by assessing the performance of the operations supported. To achieve the policy goals of the rural development policy a certain degree of complexity in the implementation of the policy is unavoidable taking into account the ambitious objectives of rural development (RD). In view of this, it has to be recognised that it will be very difficult to reach a 2 % or lower error rate without deploying unreasonable control resources at a prohibitive cost.

## Types and prevalence of errors found

### 12

As regards the types of errors indicated by the Court, it should be noted that during its own audits of investment measures and area-related schemes the Commission found shortcomings similar to those detected by the Court of Auditors. Financial corrections have been imposed on the Member States concerned (or conformity clearance procedures are underway with a view to making such corrections) in order to protect the EU budget. Furthermore, where the shortcomings were found, Member States concerned were required to take remedial actions.

### 14

The rural development policy is implemented through a national or regional rural development programme. The majority of errors relates to the specific conditions laid down in the programmes and other national rules. These are necessary for the implementation of the policy, but the challenge for the Member States is to limit these national rules to the strict necessary for achieving the policy goals.

For the programming period 2014–20 all rural development programmes are required to include an *ex ante* assessment on the verifiability and controllability of the measures, conducted jointly by the managing authority and the paying agency.

## Observations

### 26

During its own audits the Commission also found shortcomings regarding the public procurement procedures. Financial corrections have already been made in this respect.

Public procurement is one of the central elements in the action plans for rural development.

Nevertheless, it should be noted that the non-compliance of procurement does not necessarily mean that 100 % of the expenses involved are ineligible. The project as such may well achieve its goal and provide real added value.

Moreover, on 19.12.2013, the Commission adopted new guidelines for determining financial corrections to be made to expenditure financed under the shared management, for non-compliance with the rules on public procurement<sup>2</sup>. According to these guidelines, the non-respect of procurement rules is to be judged based on the principle of proportionality.

A guidance document on most common irregularities in the management of European Structural and Investment Funds has already been presented to Member States (4th Seminar Error Rate, Oct 2014).

### 27

As regards Table 1:

**Romania:** the reported error was detected by ECA in the DAS 2012. The RO Error Rate Action Plan includes measures to address weaknesses in public procurement procedures.

**The Netherlands:** procurement rules were retroactively withdrawn by the province in 2012 with effect from 1 January 2010. However, this should not have been applied in this case. The Commission is following it up with the Member State.

**Germany (Brandenburg-Berlin):** As the last commitments for broadband could be made in 2012, no further preventive and corrective actions could be implemented. Support for broadband is no longer foreseen for the period 2014–20.

<sup>2</sup> Commission Decision C(2013) 9527.

### Box 2

Sweden has included 'public procurement' as root cause of errors and corrective and preventive actions in its error rate action plan.

### 32

The weaknesses listed in Table 2 are covered in the respective action plans aiming at improving the administrative control system.

### 35

The Commission shares the view that simplification should not hamper the principles of sound financial management.

The new legal framework for CAP 2014–20 contains simplification factors which do not adversely impact the sound financial management (e.g. lump sum payments, standard costs). Article 60 of R1305/2013 establishes that only expenditure for investments that has been incurred after the application for support shall be eligible.

### Box 3

These weaknesses are covered in the respective action plans aiming at improving the administrative control system.

This is no longer possible under the new legal framework. See reply to point 35.

### 38

The lump sum payment, as in the case of young farmers support, may not respond to other measures' policy objectives. Therefore, simplification in the implementation must ensure an adequate balance with the achievement of the policy objectives and sound financial balance. The benefit on the reduction of the error rate should not be the only factor to be taken into account.

### 40

The Commission would like to point out that the fraudulent expenditure for rural development detected and reported by Member States amounts to 0,11 %<sup>3</sup>.

### 43

During its own audits the Commission also found weaknesses in the verification of small and medium enterprises (SME) criterion and non-respect of appropriate private procurement procedures. Where shortcomings were found, net financial corrections have been imposed on the Member States concerned (or conformity clearance procedures are underway with a view to making such corrections) in order to protect the EU budget. Furthermore, Member States concerned were required to take remedial actions.

In the current legal framework 2014–20, there are no limits for the size of the company in order to become beneficiary of support under investment for physical assets. Member States can target the support to specific beneficiaries following conclusions of the SWOT and needs assessment. These further requirements will have to be controllable and verifiable.

### 46

Similar provisions will be applicable during the period 2014–20.

### 48

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.

The Commission will continue providing the Member States with the recommendations and guidelines, as well as disseminating best practices to improve the control system in order to avoid errors.

<sup>3</sup> Report from the Commission to the European Parliament and the Council: Protection of the European Union's financial interests — Fight against fraud 2013 Annual Report COM(2014) 474 final.

### Box 5

These weaknesses are covered in the respective action plans aiming at improving the administrative control system.

### 51

During its own audits the Commission also found weaknesses on the conduct of administrative checks. Member States concerned were required to take remedial actions and financial corrections have been imposed, when appropriate.

### 57

During its own audits the Commission also found weaknesses in the verification of agri-environment commitments and Member States concerned were required to take remedial actions. In addition financial corrections have been imposed on the Member States concerned, when appropriate.

### Box 7

The deficiencies in Malta are largely due to the fact that beneficiaries of agri-environment measure support do not respect the commitments. The Maltese administration has undertaken many targeted information actions and has provided one-on-one trainings for certain beneficiaries.

### 59

Agri-environmental schemes reflect voluntary commitments by farmers to provide environmental benefits and environmental public goods which go beyond the mandatory requirements. The compensatory nature of agri-environment payments (covering costs incurred and income foregone) does not imply immediate economic benefits for the farmers, although these are not excluded in the longer run.

### 62

As regards the 'low' control rate for agri-environment commitments, according to the applicable legal acts, when on-the-spot checks reveal a significant non-compliance in the context of a given aid scheme or support measure or in a region or part of a region, the Member State is obliged to increase the percentage of beneficiaries to be checked on the spot.

Depending on the Member State and the individual measure, the actual on-the-spot check rate could be higher than 5 %. The correct application of this is verified during the conformity audits carried out by the Commission.

All eligibility criteria, commitments and other obligations must be checked during the on-the-spot check. If any of these can't be checked at the moment of the on-the-spot check, a second visit shall be organised.

### 63

According to the applicable legal acts, administrative checks shall cover all elements that are possible and appropriate to control by administrative means (including the respect of agri-environment commitments).

During its conformity audits the Commission also verifies whether the checks could be done in an administrative way in addition to the on-the-spot. Where appropriate, recommendations to the Member States are issued and financial corrections are applied.

Moreover, a new legal framework for CAP 2014–20 contains provisions requiring the Member States to ensure that all the rural development measures that they intend to implement are verifiable and controllable. An *ex ante* assessment of the verifiability and controllability of the measures has to be included in the rural development programme.

### 64

The Commission considers that while sanctions for non-compliance have to be proportionate, they shall remain a dissuasive tool.

Under the new legal framework, the reoccurrence must be also taken into account when calculating the reduction. It is up to the Member States to define the actual application of the criteria included in the legal texts, as well as the concrete rates and amounts thereof.

### 65

In case of serious non-compliances with the commitments, the beneficiary shall be excluded from support during the year of the finding and the next one.

### Box 10

These weaknesses are covered in the respective action plans aiming at improving the administrative control system.

### 74

Since 2012, the Commission has been addressing the issue of the high error rate by requesting national action plans from the Member States and monitoring their implementation. Based on the experiences gained and recommendations from the Court of Auditors, these action plans have been improved over time.

The expected results of all the actions will not always be evident in the short-term, especially for measures implemented through multiannual commitments. Nevertheless, the first results of the joint efforts of the Commission and the Member States to reduce error rates through the implementation of the action plans can already be seen in a lower error rate for rural development in 2013.

The Commission will keep on monitoring the implementation of the action plans, both from the audit and operational perspective, through bilateral meetings, monitoring committees and annual review meetings.

### 75

Commission's powers have been strengthened with the new CAP Regulation (EU) No 1306/2013. Article 41(2) provides that interim payments to the Member State may be suspended or reduced when it is found that key components of the national control system are not effective or when the necessary remedial measures have not been implemented. Article 36(7) provides for the interruption of interim payments as a first quick and reactive tool in case of concerns on the legality and regularity of payments.

Furthermore, in order to avoid financial corrections, each paying agency for which reservations have been made in DG Agriculture and Rural Development's annual activity report, will have to act promptly.

The Commission considers that while sanctions for non-compliance have to be proportionate, they shall remain a dissuasive tool.

### 76

Audit findings were more systematically followed up in the latest updates of action plans (September 2014). The Member States had to take into account the Court's and the Commission's audit findings to a much larger extent. Indeed, 46 % of the actions presented by Member States addressed concrete audit findings, 50 % of which came from the Court's reports.

It should also be noted that all material cases reported by the Court are followed up by the Commission, including through conformity procedure, if appropriate.



### 77

In the framework of the third update of the action plans in September 2014, the Member States were requested to provide monitoring indicators and latest known results in order to improve the efficiency of the actions.

### 78

The four joint Committee meetings for Rural Development and Agricultural Funds dedicated exclusively to the Error Rates (the Seminars) organised so far, have been a systematic process by which the sharing of good and innovative practices has taken place. In addition, it should be noted that outside the framework of the seminars and the ENDR activities, an exchange of best practices also takes place in the formal meetings of the Rural Development Committee and during the three annual meetings of the directors of the paying agencies of all the Member States.

As from 2015, the European Network for Rural Development (ENRD) will be another means by which best practices will be disseminated during the 2014–20 period. The ENRD will organise specific events, share relevant information and involve the stakeholders in aware raising initiatives.

### 79

The Commission ensures regular exchanges with the Member States on error-rate-related issues and has provided a comprehensive set of guidance documents on rural development measures and other relevant horizontal topics (e.g. simplified cost options, public procurement rules).

In particular, the SWD (2013) 244 on error rates in rural development included a common set of root causes that could eventually be relevant in all Member States, who ultimately should define by which ones they are affected, establishing the adequate mitigating actions.

### 80

Deficiencies evidenced through audit findings are being followed up by the Commission and the Member States are systematically requested to address them in the action plans.

### 81

The fact that Member States have carried out an *ex ante* assessment on the verifiability and controllability of the measures (preventive), together with a closer follow-up of the audit findings, will allow to improve the effectiveness of the action plans, as shown in the October 2014 update.

### 90

The change referred to by the Court was introduced because the cost of application of administrative penalties for small amounts could be disproportionate compared to the benefits, jeopardising therefore the sound financial management.

### 91

The Commission is fully aware of the importance of the subsequent steps of the regulatory process. In this respect the responsibilities of the Member States have been enhanced by requiring an *ex ante* assessment by both managing authorities and paying agencies of the verifiability and controllability of the measures programmed. Moreover, the Commission disposes now of reinforced preventive tools such as suspensions and interruptions, which should have a deterrent effect on errors.

As confirmed by the Court in this Special Report, gold-plating (additional and unjustified national/regional rules) has only a marginal impact to the error rate.

## Conclusions and recommendations

### 93

Since 2012, the Commission has been addressing the issue of the high error rate by requesting national action plans from the Member States and monitoring their implementation. Based on the experiences gained and recommendations from the Court of Auditors, these action plans have been improved over time.

The expected results of all the actions will not always be evident in the short-term, especially for measures implemented through multiannual commitments. Nevertheless, the first results of the joint efforts of the Commission and the Member States to reduce error rates through the implementation of the action plans can already be seen in a lower error rate for rural development in 2013.

The Commission will keep on monitoring the implementation of the action plans, both from the audit and operational perspectives, through bilateral meetings, monitoring committees and annual review meetings.

### 95 — First indent

The Commission has also found weaknesses regarding these issues in its own audits. Substantial financial corrections have already been made in this respect.

Public procurement and non-respect of commitments are central elements in the action plans for rural development.

Nevertheless, it should be noted that the non-compliance with procurement rules does not necessarily mean that 100 % of the expenses involved are ineligible. The project as such may well achieve its goal and provide real added value.

### 95 — Second indent

The Commission shares this conclusion.

The Commission will continue providing the Member States with the recommendations and guidelines, as well as disseminating best practices to improve the control system in order to avoid errors.

Furthermore, the Paying Agencies must comply with the accreditation criteria laid down in Annex I of Regulation 907/2014 (programme 2014–20) before any payments are made. Commission services reviews the accreditation through *ex post* audits.

### 96

As regards limited incentives for beneficiaries to comply with farming commitments, agri-environmental schemes reflect voluntary commitments by farmers to provide environmental benefits and public goods which go beyond the mandatory requirements. The compensatory nature of agri-environment payments (covering costs incurred and income foregone) does not imply immediate economic benefits for the farmers, although these are not excluded in the longer run.

As regards the 'low' control rate for commitments, according to the legislation in force, where on-the-spot checks reveal a significant non-compliance, the Member State is obliged to increase the percentage of beneficiaries to be checked on the spot. The correct application of this is verified during the Commission conformity audits.

The control rate for farming commitments is established at 100 % for the administrative checks and 5 % for the on-the-spot checks. The costs of management and controls published in the 2013 AAR amount to EUR 4 billion for the whole CAP. Therefore, the emphasis should be put on the improvement of effectiveness of the controls and not on their increase.

As regards the sanctions, the Commission considers that while sanctions for non-compliance have to be proportionate they shall remain a dissuasive tool.

### 97

The establishment of the action plans was conceived as a preventive process based on SWD (2013) 244, built on the self-assessment of the Member States of the root causes that had an impact on the error rates. This process has progressively incorporated the reactive perspective, systematically taking into account the audit findings and proposing specific corrective actions. The double perspective (preventive and reactive) is still part of the exercise. The last update of the action plans shows that almost 50 % of the actions were triggered by concrete audit findings of the Court or the Commission, whilst the other half were based on self-assessment of the Member States.

Furthermore, the *ex ante* assessment on the verifiability and controllability of all measures included in the RDPs 2014–20 also address the risk of error rate from a preventive perspective.

### Recommendation 1

The Commission accepts the recommendation. The specific issues raised by the Court should only be dealt with in the action plans if shortcomings have been identified.

The Commission recognises the importance of guidance related to the three root causes of errors and dissemination of best practices. This will be dealt with through the European Network for Rural Development and the seminars.

Furthermore, the Commission has already presented to Member States specific guidance on public procurement and Agro-Environment-Climate measure, including double financing. Intentional circumvention of rules is part of the Anti-fraud strategy and the seminars organised thereof in several Member States.

### Recommendation 1 — Public procurement

The recommendation is addressed to the Member States.

Nevertheless the Commission would like to underline that for the 2014–20 period, it has already presented guidance for practitioners on the avoidance of common errors in European Structural and Investment Funds projects. These guidelines were presented to managing authorities and paying agencies in the Seminar on Error Rate that took place in October 2014.

### Recommendation 1 — Intentional circumvention of rules

The Commission agrees with the recommendation which is addressed to the Member States.

### Recommendation 1 — Agri-environment payments

The Commission agrees with the recommendation which is addressed to the Member States and would like to underline that during its conformity audits it systematically verifies whether administrative checks could be carried out in addition to the on-the-spot ones. If that is the case, recommendations to the Member States are issued to increase the scope of administrative checks and financial corrections are applied.

Moreover, the legal framework for 2014–20 CAP contains provisions requiring the Member States to ensure that all the rural development measures to be implemented are verifiable and controllable.

All RDPs must include an *ex ante* assessment on the verifiability and controllability of the measures, including Agro-Environment-Climate measures, operations and concrete commitments. If these controls are not satisfactory, the RDP must be modified accordingly (Article 62 R1305/2013). Furthermore, full reduction of support is foreseen in case of serious non-compliance with commitments or breach of eligibility criteria as well as exclusion of the beneficiary from receiving support during the year of the finding and the following one.

As regards the sanctions, the Commission shares the view that while sanctions for non-compliance have to be proportionate they shall remain a dissuasive tool.

### **Recommendation 2**

The Commission accepts this recommendation. The Commission is currently assessing the controllability and verifiability of the new programmes and will raise any shortcoming in the framework of the monitoring committees and annual review meetings with the managing authorities.

Moreover, audit findings will be closely followed in order to detect and correct any source of error attributable to the national implementing rules, requesting immediate modifications if needed.

Lessons drawn from the implementation of the programmes and national rules thereof, will be shared through the ENRD and dedicated seminars on error rates.

### **Recommendation 3**

The Commission partially accepts the recommendation as it cannot prejudge the scope and the result of such analysis or future policy choices by the legislators for the next programming period.

In 2017 the Commission will prepare a strategic report of the Fund, summarising the annual progress reports submitted by Member States (Article 53 Regulation 1303/2013). Furthermore, the Commission and the Member States will assess the performance of the RDPs during the review process foreseen under Article 21 Regulation 1303/2013. In the light of these and other evidences (e.g. audit findings), the Commission will assess the policy conception and the eventual need to make proposals for the following programming period.

At the end of the programming period, the Commission will make a thorough analysis of the continued need for each support measure before making a proposal for the following programming period as has been done for the present period.

### **Recommendation 3 — Last bullet**

The Commission agrees that administrative checks should be used when possible, although it notes that in most cases this is not feasible for agro-environment operations.

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The Court estimates that the average error rate for rural development expenditure in the past 3 years was 8,2 %. Member States' control authorities did not detect the errors as checks are not exhaustive and are based on insufficient information. Some of the main causes of the errors are non-compliance with public procurement rules, suspected intentional infringements by private beneficiaries and non-compliance with farming commitments for area-related aid. The Commission and the Member States are only partially effective in addressing the main causes of the high error rate for rural development. The Court makes a number of specific recommendations for taking corrective and preventive action to address the widespread weaknesses at EU level.



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